







A SHORT TEXT-BOOK  
OF  
POLITICAL ECONOMY



BY THE SAME AUTHOR.

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A SHORT TEXT-BOOK  
OF  
POLITICAL ECONOMY

WITH  
*PROBLEMS FOR SOLUTION AND HINTS FOR  
SUPPLEMENTARY READING*

BY  
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## PREFATORY NOTE

THIS book is intended both for students who are beginning the serious study of Economics, and for those general readers who simply desire a brief account of the modern theory of Political Economy. Some hints for Supplementary Reading, selected from three well-known and easily accessible works, are given at the end of each chapter.

• It is hoped that the questions will be found useful by Reading Circles and Discussion Classes. At each meeting of such a circle the questions at the end of one chapter should be considered. A short paper on each question might be read by one of the students and then discussed by the rest, who should have read the chapter in question and as much as they can of the supplementary books.

J. E. SYMES.

NOTTINGHAM, 1906.



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## CHAPTER I

### INTRODUCTORY.

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#### SECTION A.

#### OUR SUBJECT.

Political Economy is the name given to the study which investigates the Causes of the Wealth of Nations, and of the way in which that wealth is distributed among the different individuals and classes who get a share of it. In England, for instance, there is a certain amount of wealth, *i.e.* of necessities, comforts, and luxuries. This fact at once suggests two questions—

1st, How comes it that England possesses so much wealth, neither more nor less?

2d, How comes it that particular people are able to secure that portion of this wealth which they actually do obtain, as wages, profits, rent, etc.?

Both questions are very complicated, and it is found convenient to begin by introducing certain limitations. *Instead of investigating the total possessions of England, we first confine ourselves to the annual produce of English labour.* The wealth of England, if valued in money, amounts perhaps to 10,000 millions of pounds; the annual produce to 1000 millions.

How much  
Wealth, and  
how distributed.

Limitation 1.  
We only consider each year's produce.

It is with the latter rather than with the former that we shall be chiefly concerned.

This limitation applies to both the above questions. But in dealing with the second, we shall generally introduce another

**Limitation 2.** limitation. The distribution of wealth is, as a  
 We mainly view Distribu- matter of fact, largely affected by customs, law,  
 tion as effected by benevolence, dishonesty, and other causes. *But*  
 Competition. *we shall begin by inquiring how the annual produce*

*would be distributed if only one cause—viz., free competition—determined the shares which different individuals get.* We shall begin by speaking as if all men were actuated in their business relations simply by an enlightened selfishness. In doing this we shall not imply that such a mental attitude is universal, or even general; still less shall we hold it up as worthy of admiration. But so large a part of the world's business is done on what may be called strictly business principles, that we shall reach important results by ignoring all other motives. In some departments of life this method would be valueless. If we were considering, for instance, how the comforts of a family are divided between husband, wife, and children, we should evidently have to fix our attention on quite other considerations from those which prompt business men to sell their goods at the highest price they can get. Even in business, moral and social considerations play a part. The differences between "good" and "bad" landlords and employers are not mere differences of policy or calculation. Nevertheless it may be accepted as a fact, that what we have called business principles are the predominant ones in most forms of business in such a country as England; and that we shall arrive at important approximations to facts, if we can discover how the annual produce of English labour would be

distributed among different classes under the influence of free competition.

The question whether any better or juster distribution could be brought about in other ways belongs to a later department of Political Economy. The answer we give to it must depend largely on our estimate of human nature, or rather of the effective force of different motives among the particular human beings concerning whom the question is put. In some stages of civilisation the force of custom secures a better distribution of wealth than would take place under free competition. In some, the intervention of Government will be more useful or necessary than in others, nor can any universal laws be laid down to determine whether any particular interference of Government will be beneficial. Each case has to be tried on its own merits, and with reference to a particular state of society. The preliminary inquiry of Political Economy concerns itself not at all with the question how wealth *ought* to be distributed, but simply with the question how it *would* be distributed if competition were free. It is thus evident that the subject of Distribution is treated in the first instance quite otherwise from that of Production. In the latter we shall assume an end to be arrived at, viz., the production of much wealth, while in the former we simply inquire into results, without regard, in the first instance, to whether those results are desirable or the reverse. Of course it is then open to the student to investigate what remedies, if any, are available for any results that he deplures; but this investigation is too difficult and complicated to be dealt with in an introductory text-book. It is only referred to here, because one of the commonest objections to Political Economy is based

We do not consider whether the effects of Competition are good.



on the mistake of supposing that economists approve of those results which they show to be the outcome of free competition.

## SECTION B.

### WEALTH.

**By Wealth we mean all material objects of human desire which are not to be obtained for nothing.**

**Wealth and Money.** The necessities, comforts, and luxuries of life are included under the word. He is a "wealthy" man who possesses many of them. Such a man may have no money at all. His wealth may be in the form of factories and farms, raw material and manufactured produce, furniture, horses, carriages, and so forth. Nor is he wealthy merely because he can obtain money by selling some of these. In practice no doubt such a man would (in such a state of society as we are familiar with) sell some of his goods for money. But we can conceive a state of society in which money does not exist, and in which nevertheless much wealth was to be found.

The inquiries we are about to make into the production and distribution of wealth will apply, down to a certain point, to such a society. It is found practicable and convenient to ignore the existence of Money in the earlier investigations of Political Economy, but it will of course be necessary afterwards to ask whether any of our conclusions have to be modified by the fact that all civilised societies employ money. We shall find that some modifications have to be made, but the beginner will probably be surprised to discover how little the first principles of our subject are affected by the existence or non-existence of

money. Money is an immense convenience. England could certainly not produce anything like the wealth she actually produces to-day, without availing herself of this convenience. A universal disuse of money would not immediately diminish our wealth, but it would greatly diminish the amount produced in the next twelve months, unless some efficient substitute were found. Nevertheless we shall be able to investigate many questions relating to the production and distribution of wealth before considering the functions and effects of money.

There are three kinds of wealth :—

- |  |  |
|--|--|
| (1) Such material <i>gifts of nature</i> as can be monopolised.  | (1) Natural wealth.                      |
| (2) Such material <i>products of labour</i> as are <i>direct objects of human desire</i> .                       | (2) Products directly enjoyed.           |
| (3) Such material <i>products of labour</i> as are <i>devoted to the production of other objects of desire</i> . | (3) Products used for further producing. |

The word "Land" is somewhat loosely used for group (1). It includes minerals, water-courses, and all other natural objects and forces that can be monopolised. The word "Capital" is used for all forms of wealth that fall under group (3).

It is usual to say that three things are necessary for the production of wealth, viz., Land, Labour, and Capital. This is inaccurate. There are natural forces at work producing wealth without any intervention of labour. Moreover, as Capital is itself the product of Labour, it is clear that some wealth can be produced without capital. A man placed without capital on desert island might illustrate this possibility. Nevertheless,

Land the  
prime source  
of Wealth;  
then Labour;  
then Capital.

as a matter of fact, most of the wealth that is produced is produced by the co-operation of Labour and Capital with Nature.

The subject of Production therefore falls under three heads :—

- The subject of Production.
- (1) Land as an agent of production.
  - (2) Labour as an agent of production.
  - (3) Capital as an agent of production.

The subject of Distribution must be similarly subdivided into :—

- The subject of Distribution.
- (1) Rent, *i.e.* the share of the produce which can be secured (under free competition) by those who are allowed to exercise rights of proprietorship over natural objects and forces.

(2) Wages, *i.e.* the share of the produce which can be secured (under free competition) by those who labour at producing it.

(3) Interest, *i.e.* the share of the produce which can be secured (under free competition) by those who possess and apply the products of labour to the production of more wealth.<sup>1</sup>

### SECTION C.

#### THE AGENTS OF PRODUCTION.

If we use the word "Land" in the extended sense which has been already explained, it is evident that *all wealth comes ultimately from the land*. Land provides the raw material for our food, our clothes, and our houses; for our tools and for our ornaments. It seems unnecessary

<sup>1</sup> This definition of Interest is not exhaustive, but we are not concerned with the case of any loans, except where what is lent is applied to the production of wealth.

to dwell on the purely physical causes which affect the productiveness of land. There are the widest differences of soil and climate, of mineral and agricultural possibilities, in different parts of the earth, but the enumeration of these will not help us in the investigations we are entering upon.

Again, it is only a very small proportion of our wealth that is provided without the intervention of Labour and Capital, and it is only in connection with these that Political Economy cares to deal with the productiveness of land.

We shall therefore pass at once to the consideration of *Labour and Capital as Agents of Production*. And here we come into the presence of two laws which are of paramount importance in the theory of Production. They are called the laws of "Increasing" and "Diminishing" Returns, and they simply assert that there is no necessary proportion between the amount of labour or capital applied to land, and the amount of wealth that is thereby produced. Suppose two farms, equal in every respect, except that twice as many labourers are engaged on the one as on the other. We cannot assert, without knowing more of the circumstances, whether the produce of the former will be exactly twice as great, or more than twice as great, or less than twice as great, as the produce of the latter.

Productive-  
ness of  
Labour.  
Increasing  
and Dimin-  
ishing  
Returns.

By the *Law of Increasing Returns* we mean simply that in certain circumstances an increase in labour or capital will produce a more than proportional return.

By the *Law of Diminishing Returns* we mean that in certain circumstances the increase in produce will be less than proportional to the increase in the amount of labour or capital.

FOR SUPPLEMENTARY READING.

MILL'S *Political Economy*, Introduction, Book I. Chaps. i.-iii.

MARSHALL'S *Elements of Economics of Industry*, Books I. and II.

QUESTIONS (WITH HINTS FOR SOLUTION).

1. Are slaves, roads, and bank-notes to be regarded as part of a nation's wealth?

*Are slaves part of the nation? Distinguish carefully between what is wealth to an individual and what is wealth to a nation.*

2. Are any of the following to be regarded as producers of wealth: (1) philosophers, (2) policemen, (3) actors, (4) shopkeepers?

*This question should be answered (a) on the assumption that only direct production is included; (b) on the assumption that indirect effects are considered.*

3. What reasons may be given for limiting the "requisites of production" to one or two?

*Remember that people live on wealth that has been saved.*

## CHAPTER II.

### THE PRODUCTION OF WEALTH.

---

#### SECTION A.

##### LABOUR AS AN AGENT OF PRODUCTION.

THE productiveness of Labour depends on (a) the personal qualities of the labourers, (b) the organisation of their labour, (c) the number of the labourers.

It will not be necessary to dwell on (a). It is obvious that strength, industry, and skill are conducive to production. But careful attention must be paid to (b) and (c).

Productive-  
ness of  
Labour de-  
pendent on:  
(a) Qualities  
of labourers.

Of the advantages of *Organisation*, the most striking are those included under the head of *Division of Labour*. This enables each man to devote himself more completely to the work he is best fitted for; it saves the time that would otherwise be spent in passing from one occupation to another; it increases skill, and the likelihood of inventions by the concentration it induces; it economises tools, machines, and the expenses of technical education. Modern industrialism has carried division of labour to an extraordinary degree of completeness. In our factories there are thousands of men, women, and children, whose whole work consists in constantly repeating some very

(b) Organi-  
sation, and  
Division of  
Labour

simple process, and the result is that a hundred people working in combination produce far more than a hundred times what the most competent workman could produce by himself. This is an illustration of what we have called the law of increasing returns.

It obviously gives a certain advantage to a dense as compared with a scattered population, and therefore, though it is here introduced as an illustration of organisation, the possibility of carrying it out depends largely on the number of labourers available.

In agriculture, division of labour cannot be carried out to the same extent as in manufacture. In the former, an increase in the number of labourers seldom leads to a proportionally increased produce, except in new countries, or where the population is very thin; or where a lack of capital in the hands of farmers compels them to employ too few labourers; but in manufactures the forces tending to increase the return for every additional application of labour are generally the strongest.

A thickly populated country like England seems to be at a positive advantage for manufacturing purposes; and there is no reason to suppose that if we had fewer people the produce per head would be increased. Whether wages suffer from the thickness of population is, of course, another question, and belongs to the department of the Distribution of Wealth. But there seems no sufficient ground for the assertion that

(c) Relation  
of Popula-  
tion to Pro-  
duction.

population tends to increase more rapidly than production. In England it is certain that production has increased far more rapidly than population during the past century, and it may fairly be questioned whether the density of the population has not been one of

the causes of the high average productiveness of English labourers. These not only support themselves, but produce enough to support a large class in idle luxury, a large class in pauperism, a large class who live by crime, and many classes who labour with more or less advantage to the community, but not at work which is directly productive of material wealth. The idle rich and the idle poor, clergymen, schoolmasters, actors, musicians, thieves, domestic servants, and others, have to live on what the directly productive classes produce; and though in all communities there must be a certain proportion of non-producers, it is doubtful whether a thinly populated country could possibly support so large a proportion as England does at the present day.

On the whole, then, we conclude that every increase of population opens up opportunities for fresh and superior ways of applying labour, and that if the community avails itself of these, the produce of its labour will, in most cases, be more than proportionately increased. We shall see in a later chapter how this increased produce will tend to be divided under a system of free competition.

## SECTION B.

### CAPITAL AS AN AGENT OF PRODUCTION.

We have defined *Capital* as consisting of any *products of labour which are devoted to the production of wealth*. It is thus distinguished, on the one side from *land*, which *Capital* is not a product of labour, and on the other side from those forms of wealth which are employed in the direct satisfaction of human desires. The line in each case is not easy to draw. In old settled countries the land is to some extent a product



of labour, and the food which labourers eat may be regarded either as a means of future production, or as employed in directly satisfying desires. It will generally be found convenient to omit both of these from the category of Capital, though, in some cases, as we shall see further on, it is necessary to include them. If a community possesses what is needful to sustain life and health till fresh wealth has been created, it still needs two kinds of Capital, viz., Tools and Materials. We of course include Capital mainly consist of:  
 (1) Tools; machinery under tools, and we will regard even  
 (2) Materials; finished products as materials till they have reached the hands of those who do not intend to use them for trading purposes, but mean them to be consumed by themselves, their family or their dependants. "Tools," in short, are those products of labour *with which* the producers operate; while "Materials" are those products of labour *on which* they operate.

The possession of tools is, of course, a great advantage in production. Robinson Crusoe, with spade, gun, and knife, was in a very different position from that which he would have occupied without them. He could not eat them nor wear them, but they enabled him to get food and clothing in far greater abundance, and with far greater ease. In a primitive society men are induced to create capital by the fact that in the long-run they will thus produce more of other kinds of wealth. The fisherman who spends some hours daily making a canoe, looks forward to more than recouping himself for the time he might have devoted to fishing, and this end may be equally served whether he himself uses the canoe, or whether he lends it out to his neighbours, receiving in return a portion of the fish which

they catch from it. Such a man may well benefit both himself and the tribe. The increased produce provides a fund from which both the owner and the borrower of the canoe may get an advantage. So it is with the machinery and other kinds of "tools" used in modern industrialism. We are not yet in a position to consider whether the extended use of machinery is beneficial or injurious to the working classes, whether it forces down their wages or not. We only notice that the machinery (if successful) causes a greater production of wealth, and therefore at least makes it *possible* for *all* classes to obtain more of the necessities, comforts, and luxuries of life. Whether they actually do so or not belongs to the branch of Political Economy which deals with the distribution of wealth.

We have hitherto been speaking of tools and materials, but in modern industrialism Capital takes also a third form, under which it discharges two distinct functions. The means of subsistence, or the money by which such means can be purchased, are to a great extent in the hands of persons other than those who are employed in the production of wealth. Capitalists often advance to labourers those means of satisfying their wants or their desires. This is by no means invariably done. In many cases the labourers are paid at the week's end out of wealth which they have themselves produced during the week. The payment is generally made in money, but the money itself has often been obtained in return for the products of the previous week's labour. A man might successfully work a manufacturing business, even though he started with no other capital than tools and materials. He might pay the wages at the end of the first week out of what he had obtained during

but (3) Capitalists often advance the means of living.

the week by the sale of the products. Even when the returns are not rapid enough for this, the payment of wages does not generally trench on the employer's capital. For the addition made to it during the week by the labour of those whom he employs is generally greater than what he pays out at the week's end. Unless this were so, taking one week with another, the business must fail. Nevertheless in such cases an advance is really made. The employed have given more than an equivalent for it; but as they do not possess sufficient means of subsistence to wait till the result of their labour has been exchanged for what they need, they will have to accept something less than what they would otherwise have obtained in return for the convenience of getting their remuneration at the week's end in a form which suits them.

Lastly, it has to be remembered that in modern industrialism the employing class generally takes the risk which is involved and (4) take in almost all productive work. We shall have at the risk. a later time carefully to distinguish between employers and capitalists. An employer may work with borrowed capital, and a capitalist may not be directly an employer. For the present, however, we may regard this taking of the risk as a function of Capital, since some wealth may fairly be regarded as set apart as a sort of insurance against loss, and this is a help to production.

It has next to be noticed that Capital, like Labour, is subject to laws of increasing and diminishing return. A man who doubles the capital which has hitherto been applied to a farm may find his produce has been more than doubled. If he goes on doubling the capital applied he will probably soon reach a point at which

Diminishing  
and Increasing  
Returns  
of Capital

the returns will be diminishing. This will specially be the case if the new capital is applied in the same way as the old. In manufactures the rule seems at first very similar. A man who went on applying more and more capital to his business would reach a point at which the returns ceased to be profitable. But this is mainly because his increased production would cause a fall in prices. The produce itself would generally be more than proportional to the increased capital, for production on a large scale is, in manufactures, generally more economical than production on a small scale. This may be expressed by saying that the Law of Diminishing Returns has less effect in manufactures than in agriculture.

### SECTION C.

#### THE PROBLEM OF PRODUCTION.

We have spoken of Land, Labour, and Capital as agents of production. Let us now return to the question, "How comes it that England produces so much wealth, and no more, in any particular year?" It will be seen that some light has been thrown upon this. The amount produced is due, partly to the *Land*, i.e. the natural resources of the country; partly to the *Labour*, i.e. to the number, qualities, and organisation of those who have worked at producing wealth in that particular year; and partly to *Capital*, i.e. to the quality and quantity of tools and material devoted to production, and, to a less extent, to the capacity possessed by some of advancing wealth for the subsistence of others, and of running the risk of losses from industrial operations.

Now the problem of Production is practically this: How

shall a nation produce the most wealth, starting with any given conditions of natural resources, population, and wealth

The production of Wealth may be increased that has been saved, and is available for productive purposes? The natural resources are a fixed quantity, though they may be utilised or neglected.

The only means of increasing production must be through by improving or increasing Labour or Capital. To improve the quality of Labour, and to increase the quantity of Capital, are the principal ways of increasing the produce, so long as the population remains fixed.

Of course much depends on the *quality* of the Capital. It is not a matter of indifference whether our tools are good or bad. But the quality of the Capital produced depends on the previously existing resources, and the quality of the labour applied to them, including knowledge, skill, inventive power, and organisation, in the term "quality of Labour."

Again, the quantity of Labour is an important item in production. But we have already seen that the ratio of population to produce is neither fixed, nor necessarily increasing, nor necessarily diminishing. The effect therefore of an increase in population on the produce per head cannot be stated generally. We are thrown back on our two factors, quality of Labour and quantity of Capital, as the only two of which it can be universally said, that any advance in them will lead to an increased production.

Even here we need not stop our analysis. For the quantity of Capital obviously depends: (1) on the power, (2) on the will, to save; and with given natural resources both these depend mainly on the industrial qualities. The power to save depends on the excess of production over consumption. The will to save depends mainly on

the quality which we call thrift. Both factors depend therefore on industrial qualities, and the problem of production is therefore the problem of how these qualities are to be drawn forth. To discuss how the industrial qualities of a people may be developed would require a lengthy treatise, which should include such a vast subject as education—physical, intellectual, and moral. We will only notice in passing that it is as important to improve the quality of the labour of employers as that of employed. Efficient labour badly directed will often be less productive than inferior labour wisely organised, and directed into the most profitable channels.

#### SUPPLEMENTARY READING.

MILL, Book I. Chaps. vii.—ix. 11 and 12.  
MARSHALL, Books III. and IV.

#### QUESTIONS (WITH HINTS FOR SOLUTION).

1. How does honesty tend to increase the productiveness of labour?
2. Can you suggest any disadvantages of division of labour?  
*Does it make work monotonous, and employment uncertain?*
3. Should you expect the average productiveness of labour would be greater in an English manufacturing town where the population is 100,000 to the square mile, or in a fertile new country where the population is 10 to a square mile? Explain fully the grounds on which you found your opinion.  
*Notice the number of idlers and unproductive workers supported in the town out of the produce of the producers; and the number of large incomes.*
4. Discuss the question whether wages should be considered as paid out of Capital.  
*Consider whether wages normally trench on Capital, and, if so, in what degree? In what sense is it true that the amount paid in wages depends on the actual or expected produce of the labour for which the wages are paid?*

5. Should you regard the loaf in a labourer's cupboard, or the coat on his back, as Capital? Give reasons for your answer.

*Show the distinction between these articles and similar ones in a baker's or tailor's shop. If you answer the question in the affirmative, is it possible to distinguish Capital from Wealth? Do you see any connection between this question and the previous one?*

6. Will the "will to save" depend much on the rate of interest obtainable for savings, and, if so, does this fact modify the view that "the will to save depends mainly on thrift"?

*Show that a low rate of interest to some extent INCREASES the motives for saving, and deal with the question historically, and from the point of view of actual facts.*

7. "The flight of the Huguenots impoverished the country they fled from, and enriched the countries they fled to."

"The population of Ireland in the last 150 years rose from three to eight millions, and has since fallen below five millions. The condition of the people was never worse than when the population was at its lowest."

Consider these two statements in connection with the laws of "Increasing" and "Diminishing" Returns.

## CHAPTER III.

### THE PROBLEM OF DISTRIBUTION.

HAVING indicated the kind of causes which determine the annual produce of a nation's labour, we pass on to consider the Division of that Produce among Landlords, <sup>What is, or</sup> ~~What ought~~ Capitalists, and Workers of all sorts. Two <sup>to be?</sup> courses are open to us: (1) We might consider how the most just and equitable division of this produce could be secured; or (2) we may simply ask how the division will be made, if all parties intelligently pursue their own interests.

The former question is full of interest, and also of difficulty. Men differ widely from one another in their views as to what sort of distribution would be a just one. They differ almost equally in the question how far any interference, by the State, or otherwise, could ensure a juster distribution than actually takes place. It has, moreover, to be noticed that such interferences may diminish the amount of wealth that is produced, and in the end leave less for all who obtain a share. We shall not in our later chapters altogether ignore considerations of equity. But we shall regard the second question as the problem which chiefly concerns us, not because it is the more important, but because it admits of a more scientific treatment. It is also an



almost necessary preliminary to any question of State interference, and of other methods by which the admitted evils of free competition may be mitigated or cured. Our main problem is therefore the following:—Assuming a certain Produce, *i.e.* a certain amount of wealth produced by the application of labour and capital to natural resources, we have to discover what share of this will be obtained under free

competition, (1) by the owners of land, or other natural resources, (2) by the owners of capital, *i.e.* created wealth applied to production, (3) by workers of various kinds in return for their labour. These three classes do not, of course, correspond with the actual

divisions among men. Many landowners are capitalists, and many capitalists are workers; but the remunerations obtained for land, labour, and capital respectively, depend on distinct facts and laws, and must be investigated separately.

The fundamental fact of distribution can be best expressed in the following equation—

The Equation of Distribution.  $\text{Produce} = \text{Rent} + \text{Interest} + \text{Wages}$ , where,  
 $\text{PRODUCE} =$  the increase made in material wealth, the net produce that remains after any auxiliary capital that may have been consumed is replaced;

$\text{RENT} =$  the total amount received annually for the use of natural objects and agencies;

$\text{INTEREST} =$  the total amount received annually for the use of Capital;

$\text{WAGES} =$  the total amount received annually in remuneration for labour of whatever kind.

Thus in the above equation we include under "Wages" the remuneration of employers for the work of organising,

and supervising the labour of others; we include under "Interest" what is usually called rent, so far as it is paid for anything that has been produced by labour; and we limit the word "Rent" altogether to payments made for the use of land and other gifts of nature.

The student must carefully familiarise himself with this use of the words. It is greatly to be regretted that in this, and some other instances, we are compelled to use words in other than their ordinary meaning; but where ordinary parlance confuses things fundamentally different, such as the "rent" of a house, and the "rent" of land, things which depend on altogether different laws, our only alternative would be to invent new terms, the signification of which it would be still more difficult to understand.

Obscurity as  
to meaning  
of terms.

The difficulty is perhaps most serious in the case of the word "Wages." If the word "Profits" could be taken to express the earnings of employers for the labour which they undergo, our equation might be put into the form  $\text{Produce} = \text{Rent} + \text{Interest} + \text{Profits} + \text{Wages}$ . For some purposes this would be the most convenient form of the equation. But the word "Profits" is almost invariably used to include interest on capital, as well as remuneration for employer's labour, and if so used, the second form of the equation would count twice over one portion of interest. The balance of advantage seems to us therefore in favour of the earlier form of the equation.

In modern industry we generally find that employers are themselves capitalists. Even if a man begins business altogether with borrowed capital, he generally becomes, if fairly successful, a capitalist, and

Employers  
generally  
Capitalists.

it frequently pays him best to put his savings into his own business rather than to lend them to others. He either pays off some of what he has borrowed, or he extends his operations. He thinks of his profits in relation to his capital, though of course he knows that their amount depends as much on his ability or good fortune as on the amount of his capital. But for purposes of theory it is most convenient to think of the employer as if he had no capital of his own. Let us suppose that he has started business with £5000, borrowed at five per cent. With this he has bought a factory, machinery, etc.; but he has to pay a ground-rent of £100 a year, which we will suppose to be the value of the land on which the factory is built; he has to pay £6000 a year in wages, and £4000 a year for raw material, and in repairs and similar expenses. In this case we have Rent, £100; Interest, £250; Wages, £6000; other expenses, £4000. The remuneration for the employer's own labour will be got by deducting all these from the price of the finished products. Let us suppose this price amounts to £12,000. Then his remuneration will come to £1650. If the capital had been his own, his profits would have amounted to £1900. Another manufacturer, less skilful, less economic, or less fortunate, might perhaps in similar circumstances have only made £300 profit. In his case too we have to deduct interest on the capital, and the remuneration for his labour would only be £50 for the year.

We shall see at a later time that in modern industrialism it is generally the employer who takes the risk that what is produced will not fetch the estimated or expected price. The rent, interest, and wages he pays are generally agreed on beforehand, and do not depend on the

But in theory all Capital may be considered as borrowed.

Employer takes risk.

actual value of the produce, though of course he would not have agreed to pay these amounts unless he *expected* that the produce would exceed his expenditure, and that by an amount that will compensate him for his labour and for the risks that he runs. He may indeed be in such a position that he has to face the probability, and even the certainty of loss, and can only select the least disastrous of several courses; but normally the employer undertakes to pay a *fixed* rent and a *fixed* interest and *fixed* wages (fixed at least at the beginning of the week, or day, or hour), under a belief that the results will be such as to compensate him for his expenditure, and also for his labour of superintendence. The employer thus stands in a different position from all the other parties in an industrial occupation. The rent of the landlord is settled *before* the tenant occupies the land; the interest to be paid on the capital is similarly agreed on *before* the capital is lent; the wages of the labourer are generally agreed on *before* the work is done; but the employer's profits are only fixed *after* his work is done, and his produce has been sold.

The amount he pays is agreed on before the produce is sold.

It does not necessarily follow that the employer *advances* either rent, interest, or wages. He has pledged himself to pay them (perhaps annually, or quarterly, or weekly). But he may get his returns before his rent, interest, or wages fall due, and in that case it is the other parties in the industrial work who advance their land, capital, and labour. Even when the employer has not turned the produce into money, he has usually received his money's worth before he has to pay to landlord, lender, or workman.

But he does not always advance this.

The essence of the situation is that he takes the risk of a

favourable or unfavourable result. Of course the landlord, lender, and workman take the risk that their rent, interest, and wages will not be forthcoming. We ought therefore, in strict accuracy, to qualify the statement that employers generally take the risk by the hypothesis that all parties fulfil their contracts.

Again, it has to be noticed that business is sometimes conducted on other principles. The reader may advantageously imagine the case of a man who, after working with borrowed capital, turns his business into a joint-stock concern, and becomes himself the manager thereof. To make the comparison closer we will suppose that those who originally lent the capital now become the shareholders in the company. It is possible that the manager's salary will equal what before was the remuneration which the employer secured for himself, and that the shareholders now get as dividends what before they received as interest. Yet the fact remains, that the risk has been shifted from one party to another.

Now it might appear at first that if the employer takes the risk, he will expect, and usually secure, some remuneration for this, and indeed we find in most political economies that "compensation for risk" is regarded as one element in profits. But it may be questioned whether such compensation is really gained. Suppose a man who has hitherto superintended some one else's business for a fixed salary of £500 a year, settles to start on his own account, and suppose his profits (after deducting interest in capital) amount to £400 in the first year, and £600 in the second. It is plain that so far he has got no compensation for risk. He has averaged £500 as before.

The above  
arrangements  
not the only  
ones.

Compensation  
for risk  
balanced by  
losses.

The question is whether this represents a normal state of things, or whether, as a rule, a man working on his own account averages more than if he worked for a salary. It may plausibly be maintained that every one would prefer the fixed salary to the irregular earnings, unless the latter were on an average the higher. But it must be remembered that there is a certain attraction in risk; that many men over-estimate their own chances; and that there is a further attraction in the independence and social position of the man who conducts his own business. It is probable that these things, at least approximately, balance the dread of uncertainty, and therefore it may be questioned whether anything should be allowed as "compensation for risk" when we come to consider the earnings of employers. The lucky man, no doubt, gets something more than the natural reward of his industry and ability, but it may fairly be doubted whether this excess is not balanced by the losses of the unsuccessful. We are dazzled by the great fortunes which some employers make; but we should not forget to set against these the men who get less than nothing as remuneration for their work: those who get less than the normal interest on their capital, and those who even lose some of this capital.

We will next remark that our equation only deals with what may be called the *first* Division of the Produce. If we take the case of a landowner's butler, we should naturally count his remuneration as wages; but it is evidently paid out of what has gone to the landowner as rent. Our first division only puts under wages the remuneration of those who are productive labourers in the narrowest sense, *i.e.* who are *directly* engaged in the production of *material* wealth. An actor's remuneration may

The above  
only a first  
Distribution  
of Produce.

come partly out of rent, partly out of interest, and partly out of wages, but in any case it is not part of the original distribution. The neglect of this distinction has led to serious errors in calculations of national income. Statisticians have spoken as if this could be estimated by adding together the incomes of all the individuals of the nation; but if we include the incomes of our landowner and his butler, we have counted twice over what the butler receives.

The first division accounts for all the produce; but the sharers in it subsequently transfer portions of their shares to persons who render them real or supposed services, or to those to whom they choose to make gifts.

Thieves, again, may enjoy considerable incomes, but these incomes form no part of the original shares into which the produce is divided. The thieves secure for themselves a portion of what originally went as rent, interest, or wages; but we are not concerned with this in our original problem of Distribution.

### QUESTIONS.

1. How far is it true that society may be divided into workers, thieves, and paupers?

*The cases of those who live on rent, on interest, on the earnings of parents and husbands, and on free gifts, have to be considered in relation to the proposed classification.*

2. Is any of the amount raised in taxes included in what we have called the first Division of the Produce?

*Consider for what purposes taxes are levied. Are policemen, soldiers, judges, poor-law officials, sanitary officials, etc., aiding production?*

3. Explain fully the exact meaning you apply to each term in the equation:  $\text{Produce} = \text{Rent} + \text{Interest} + \text{Wages}$

## CHAPTER IV.

### RENT.

THE fundamental cause which enables landowners to obtain rent is the difference in fertility and utility that exists between the various portions of the earth's surface. So far as rents are fixed by free competition, the differences in rents corresponds exactly to the difference in utility. A farmer is seeking a farm, and two farms are offered to him. If he considers that he will be able to raise £800 worth of crops from the one, and £850 worth from the other (by the application of the same amount of labour and capital), he will be ready to pay exactly £50 more in rent for the second, if the farms are in other respects equally suitable. If the difference in the rents asked is £49, he will take the better farm. If the difference is £51, he will take the worse. The difference in expected produce will exactly determine the amount of extra rent he will be willing to pay. Let us suppose he is asked £100 for the one and £150 for the other. But now comes a third landlord into the field, and offers a farm absolutely rent-free. Our farmer will then estimate what he could produce on this third farm with the same expenditure of labour and capital. If he estimates it at less than £700 he will decline the offer. By taking the first or second farm he will get a produce of £700 in addition to

Rent due to differences in utility,

and tends to correspond with the difference.



his rent, and either of these will pay him better than the one he may occupy rent-free. Let us suppose, however, that he estimates the produce at exactly £700. The three offers are now exactly equal. If there were nothing to be considered except the balance of produce after paying rent, there would be nothing to make any of the three offers more attractive than the other.

The tendency of competition is to bring about this sort of equilibrium in all departments of business. The competition of farmers pushes rents up; the competition of landlords pushes them down; the competition of employers raises wages; the competition of workmen depresses them. Some temporary equilibrium is everywhere established, or, at least, the forces at work are always tending to secure equal prices for like commodities, equal wages for similar labour, equal interest for each £100 that is invested with equal security.

Returning, then, to our original illustration, we are now in a position to determine how much rent could be obtained from one farmer for any farm in the kingdom, provided we know at what he estimates the produce he expects to get from it by a given investment of capital and labour, and provided he is influenced by no considerations other than the rent and the expected produce. We have assumed that he can get a balance of £700 after payment of rent from any of the farms offered to him as yet. He will clearly require to get at least as much from whatever farm he ultimately takes. The maximum rent he is willing to pay will therefore be got by subtracting £700 from the expected produce. But while the competition of other landlords will tend to prevent the rent from rising above this, the

Equalising  
tendencies of  
Competition.

Law of Rent.

competition of other farmers will tend to prevent its falling below a minimum, which will constantly approximate to this maximum. If we define "normal rent" as that rent towards which competition tends to push actual rents, we say that the normal rents of the three farms we spoke of first will be £100, £150, and nothing, respectively. We will use the term "margin of cultivation" to indicate the sort of land such as that on our third farm, which it would just pay to cultivate if no rent were charged from it. If the student has grasped our reasonings above, he will see that our conclusions can be generalised in the following form:—*The normal rent of any land is got by deducting the produce of land on the margin of cultivation from the produce of the land in question.*

This is a way of putting what is known as Ricardo's "Law of Rent." It is, as we shall see, a useful form for expressing a truth included in our original statement, that (so far as rents are fixed by competition) the difference in rents corresponds with the difference in utility of the lands in question.

Some rent can be obtained for all land that is better (to however small an amount) than that on the margin of cultivation. If, for any reason, the margin of cultivation descends (*i.e.* if it pays to cultivate land which formerly it did not pay to cultivate), all rents will normally increase. Returning, for instance, to our illustration, let us suppose the price of agricultural produce to rise by ten per cent. So that the crops on the three farms would now sell for £880, £935, and £770. It would now pay our farmer to take land even inferior to that on the third farm, if he could get it rent-free. Let us suppose it would pay him in the new circumstances to take land that would produce crops worth £730. The normal rents of the three

Rents rise as  
Margin falls

other farms would therefore be £150, £205, and £40, instead of £100, £150, and 0. It may be stated as a general truth,

Upward  
tendency of  
Rents. that whatever tends to bring fresh and inferior lands under cultivation, tends also to raise the rents of all land previously cultivated. Thus

when a community advances in wealth and population there is a rise in rents, unless some counterbalancing force is

operating. Among such counterbalancing forces But there are forces that may balance this. the importation of agricultural products from abroad deserves special notice. It is this which

of late has caused a fall in agricultural rents in England. The importation of foreign wheat causes the margin of cultivation to rise. It is not necessary to resort to land of as poor a sort as must otherwise have been cultivated, and accordingly the rent of all wheat-growing land is less than it would otherwise have been. In the years following the abolition of the Corn Laws there was such an immense increase in wealth and population that rents rose in spite of the foreign importation; but of late the balance has been the other way. . .

The rent of land for building purposes in towns is subject to the same law as that of agricultural land; only that we should have to speak of the difference in convenience instead of the difference of produce. If a man hesitates between two plots for which very different rents are asked, it is because he doubts whether the difference of advantage exceeds or falls short of the difference in rent. When it pays to build on land which had previously been below the building margin, the owners of the more convenient lands can obtain higher rents than before. Accordingly we generally find that when a town is growing in

wealth and population the value of each plot is steadily increasing. The phrase "unearned increment" is sometimes used to indicate that this increase is not due to any action of the landlord (as such). But in reality all rent in the politico-economic sense is "unearned"; for it is by its very definition a payment made for gifts of nature, and not for the produce of labour.

The "rent" of a house, as distinguished from that of the ~~land~~ on which it is built, is not, in our sense, rent at all. It is a form of profits on capital invested in the building trade. The rent of mines is subject "Rent" of Houses. theoretically to the same laws as that of land used for other purposes, so far as both are regulated by competition. In practice the method of determining the rent of Rent of Mines. mines varies considerably in different districts.

The comparative complexity of this form of rent is due to the fact that mines get exhausted. Agricultural land is not necessarily deteriorated by each harvest. At the end of a long lease the land may be returned to the landlord in as good a condition as when it was first leased. Much wealth has been taken from it, but nature and art have combined to make good the loss. In mining it is different. A mine would fetch little or no rent if it had to be returned in as good a condition as when it was taken; but, on the other hand, if the tenant were to pay a fixed rent, with the privilege of raising as much of the mineral as he thought fit, it would often pay him to exhaust the mine, even when its produce fetched such a low price that, if he were the owner, he would limit the output. One common way of partly reconciling the interests of the two parties is by fixing the rent very low, and charging an additional royalty proportional to

the tonnage of the mineral extracted. Under such an arrangement it is obvious that a fall in the price obtainable for the mineral in question will act as a more effective check than if the mine were hired at a fixed rent.

We will now return to agricultural rents, and indicate some of the chief causes which modify the effects of competition.

(1) *Custom.* In many countries this is the chief regulator of rent; and even in our own it considerably checks the operations of competition. A landlord, from idleness, ignorance, or good-nature, will continue for years to accept a rent somewhat less than what he could obtain in the open market. Social and political considerations, family traditions, a sense of duties or of advantages that are not pecuniary, may operate in the same direction. The tenant, on the other hand, reluctant to leave the farm or the neighbourhood to which he is accustomed, and dreading the risks and dangers of the unknown, will sometimes continue to pay a rent higher than any other tenant could be found to pay. The difficulties and expense of moving will help to keep rents from falling as much as they otherwise would in times of agricultural depression; but as a general rule English agricultural rents are below the point at which Ricardo's law would place them. In many parts of Europe the tenants pay as rent a definite proportion of the produce of the farm. This is called the *métayer* system. A little consideration will show that it is far more favourable to the tenant than that of free competition, so long, at least as it does not operate in diminishing the produce, by removing some of the motives which induce men to put out all their powers.

Effects of  
Custom on  
Rents.

(2) *Law.* The Legislature can, of course, intervene and forbid the exacting of the full competition rent. Such an intervention is in effect a partial transfer of ownership. Take two farms which in the open market would fetch £30 and £40 respectively.

Effects of  
Law on  
Rents.

Suppose some State agency fixes the rents at £25 and £32. The State has practically presented one tenant with one-sixth and the other with one-fifth of the land value for the current year. If the landlord is allowed to eject the tenant, without compensation, the law will probably be evaded; for those who would be willing to pay £30 a year, for a farm whose rent is fixed by law at £25, will be glad to give some other compensation for the advantage of occupying it at the legal rent. If, however, there are legal or social difficulties in the way of eviction, the reduction becomes (so far as these difficulties are effective) a gift to the tenant. It must be noticed that rents, as fixed by competition, correspond with natural difference in the utility or convenience of different plots of land. The law can determine to whom this advantage shall go. It may assign the full rights of proprietorship to Lord A., and let him get as much rent as he can; or it may vest the proprietorship in farmers B, C, D, etc.; or it may make the State the proprietor, and devote rents to promoting the welfare of the community; or, again, it may set up a dual system of ownership, under which Lord A. gets only a certain share of the natural advantages of a certain land (over those of a land on the margin of cultivation). But the law cannot alter these *natural* advantages; it can only determine the proprietorship of them. Suppose Parliament passed an Act abolishing all rents, it would simply make the present tenants into landlords. It would be giving £30 a year to one farmer.

and £40 a year to another. The tenant who farmed only land close to the margin of cultivation would receive nothing, or next to nothing, while the lucky man who had taken rich land at a high rent would get a big prize. It is often said that if the farmers had less to pay in rent they could give their labourers higher wages; and from the illustration given above it will be seen that some of them no doubt could afford to do this, but there is no reason to suppose that they *would*. Small proprietors who pay no rent at all, do not, as a rule, pay higher wages than tenant farmers, and so far as wages are settled by competition, the remission of rents would not affect them. In the same way the price of wheat and other agricultural produce would not be affected by an Act remitting all rents, except perhaps in some indirect way. No doubt if you present a farmer with his rent he could afford to sell his wheat somewhat more cheaply, but so long as he can get the old price he will not voluntarily accept a lower, at least if he is influenced by ordinary business principles. Whether wages and prices can be regulated by law is a matter for later consideration; but it is worth noticing at this point that legislation directed to lowering rents will not necessarily, or probably, lower prices or raise wages.

(3) *Sentiment*. This modifier of competition has been partly referred to under the head of "Custom." In rural

England sentiment has certainly exercised a great influence on rent. Our larger landlords have seldom looked on their land simply, or even mainly, from a business point of view. Their social and political position has partly depended on their being "good" landlords. Many of them have been animated by a sense of duty, or by pride, rather than by a desire to get the highest

Effects of  
Sentiment  
on Rents.

possible rents with the least possible outlay. Other sentiments, already partly referred to, might be mentioned in this connection. Some of them spring from ignorance, carelessness, or stupidity on one side or the other; some of them from nobler sources of neighbourliness, or persistency. It is not for political economy to pronounce judgment on such sentiments, it only notices their existence and their influence.

But in spite of all the necessary modifications and qualifications, it is probable that in such a country as England the Ricardo law would give a result which in most cases is fairly approximated to by actual rents. Differences in rent correspond on the average with difference of produce, except so far as the latter is caused by difference in ability, industry, or capital. Rents fall when land is going out of cultivation, and rise when it pays to cultivate land which had not previously been worth the cultivating. Even in those countries where custom seems to regulate rents altogether, it will be found that there are forces at work tending to modify the results in the direction which Ricardo's law would indicate.

Ricardo's Law valuable in spite of difference between actual and normal Rents.

### SUPPLEMENTARY READING.

MILL, Book II. Chaps. vi.-x., xvi.

MARSHALL, Book V. ; Book VI. Chaps. ix. and x.

### QUESTIONS.

1. "The metayer system is more favourable to tenants than one which leaves rents to be determined by free competition." Discuss this statement.

*Start on assumption that other conditions are identical. Then consider how the system would be likely to modify other conditions. Take the case of a vacant tenancy for which there are several applicants.*



2. What is the connection between Ricardo's Law and the Law of Diminishing Returns?

*Take the case of a farmer applying successive doses of capital to his farm till it ceases to be profitable to apply more.*

3. Would a land-tax proportional to rent fall ultimately on the landlord or on the tenant?

*Consider first whether it makes much difference whether it is levied directly from the one or the other.*

4. How does a system of leases affect rents?

## NOTE ON SUPPLY AND DEMAND AS AFFECTING VALUE.

THE theory of Value will be examined in a later chapter; but it is necessary at this point to speak briefly of the relation of Value to Supply and Demand.

We measure the "Value" of a thing by what can be obtained in exchange for it. A loaf of bread is more useful than a diamond; but not more valuable. In practice the value of a thing is usually measured in money. It is then called the "Price."

By the "Supply" of any commodity we mean the quantity offered for exchange or sale. Thus on a given day, in a given market, the supply of strawberries would be the whole quantity of strawberries on sale.

By the Demand for a commodity at any price, we mean the quantity that would be bought at that price. Thus the demand for the above-mentioned strawberries is a vague, and even unmeaning phrase, till some price is affixed to them. At 6d. the lb. the public might only be willing to buy 40 lbs. But at 5d. perhaps a 100 lbs. would be demanded, and at 4d. 200 lbs. might be taken.

We plainly cannot say whether the demand is for 40, 100, or 200 lbs. till we know the price asked.

But there is a general tendency for dealers to ask a price that makes the Demand nearly equal to the Supply. If the supply were 100 lbs., and they correctly judged the public demand, they would not stand out for 6d. a lb. (in the case given above), for that would involve their failing to sell 60 lbs. of their strawberries. Neither would they be satisfied with 4d. per lb., for they could sell the whole stock at 5d. Perhaps they might begin by asking 6d., and only after experience of the slow sale that ensued come down to 5½d., and ultimately to 5d. This illustrates the general principle that Value (or Price) tends towards the point at which the Demand will equal the Supply.

Supply  
adapted to  
Demand.

This result is due to competition. The competition of sellers tends to push prices downwards, while the competition of buyers tends to push it up.

An increase in supply is almost equivalent to a greater competition among sellers; an increase of demand to a greater competition among buyers.

Hence it follows that, *other things being the same*—

- |   |   |
|---|---|
| (1) When Supply increases, Value (or Price) tends downwards.  | Effects on<br>fluctuations<br>in Supply or<br>Demand. |
| (2) When Supply diminishes, Value (or Price) tends upwards.   |   |
| (3) When Demand increases, Value (or Price) tends upwards.    |   |
| (4) When Demand diminishes, Value (or Price) tends downwards. |   |

We shall use these facts in the following chapters, and have therefore introduced them here, though their natural place is in the Chapter on Value.

## CHAPTER V.

### INTEREST.

By **Interest** we mean the *price paid for the use of Capital*. Lenders generally run some risk of losing all, or part, of what they lend. In some cases the risk is very great, and the borrower must pay heavily for the loan ; but we shall not include payments for risk under the term "Interest."

Definition of Interest.  
Insurance for risk excluded.

The rate of interest depends on the supply of loanable capital and the demand for loans. Where there is much loanable capital, the competition of those who want to obtain interest forces the rate of interest down. Where there is much demand for loans, the competition of those wishing to borrow forces the rate up.

Capital has been defined as *Wealth saved and devoted to production*. In countries like our own, most of the wealth saved is so devoted. Accordingly the supply of Capital is nearly equal to the difference between wealth produced and wealth consumed.

Capital, the balance between Production and Consumption.

The supply of Capital may therefore be increased by increasing Production or by diminishing Consumption. The excess of the former over the latter depends on the strength of *the will to save as compared with the power of doing so*. The power to save is measured by the difference between production and that

Will to save and power to save.

degree of consumption which makes this difference a maximum. The will to save depends mainly on the qualities of thrift and of providence.

It is doubtful whether the rate of interest greatly affects men's readiness to save. Some men no doubt save more when the rate of interest is high; but others feel the obligation of saving most strongly when the rate is low. The qualities of thrift and providence are generally found to be strongest where only a low rate of interest is obtainable; but in these cases the low rate is the result of the large supply of loanable capital, which is itself due to the thrift and providence.

In new countries where men of an industrial race have settled, the demand for capital is great, and the supply of it comparatively small. The rate of interest is therefore high, even when the risk is not great. New countries.

As society advances capital accumulates, and though the demand for it may grow, it only keeps pace with the supply by means of a fall in the rate of interest. In Old countries. England during the past century there has been an immense increase in the demand for capital, from the growth of the population, the development of railways, and other applications of steam, the multiplication of inventions and discoveries, and many other causes. But the accumulation of capital has been so great that more than enough for all these demands would have been available at the old rate of interest, and there has consequently been a downward tendency. In our own country the amount paid for the use of capital, after deducting remuneration for risk, does not exceed *3 per cent.* It would probably have reached a much lower point but for the fact that much English capital has

been attracted abroad, especially to our Colonies and to the United States.

The tendency of interest to fall as society advances may be contrasted with the tendency of rents to rise. The contrast

**Contrast of Interest and Rent.** shows us the importance of excluding land from the category of capital. People have to pay much higher for the use of land (especially of land

in towns) than they had to pay in the Middle Ages; on the other hand, they have to pay much less for the use of capital.

**Gross Interest may rise as the rate falls.** Nevertheless it must be remembered that while the rate of interest falls, the gross amount paid in interest may be (and generally is) increasing in progressive societies. If we return to our equation—

$$\text{Produce} = \text{Rent} + \text{Interest} + \text{Wages},$$

we find that both landlords and capitalists are in this case taking an ever increasing slice out of the produce.

If we eliminate differences of risk in accordance with our definition, we shall find that in any market there is but one rate of interest. With equal security (or at least with what he considers equal security) a lender is generally equally ready to lend for one industrial purpose or another.

It might at first seem that even in different markets the rate of interest must be at any time approximately equal for

**But not in different markets.** any given security. But it must be remembered that a given individual's credit will not be the same in different markets. Take, for instance, an

Australian farmer wishing to borrow £1000. He finds that at Melbourne the rate of interest on approved security is 10 per cent., while in London it is only 3 per cent. But while his credit is perfectly good in Melbourne, where he and his

farm are well known, it may well be that no lender would be found in London to advance the money even at 10 *per cent*. His credit in Melbourne is better perhaps than that of a London merchant who can borrow in London at 4 *per cent*. The two men's businesses are perhaps equally sound and equally risky, yet one has to pay more than twice as much as the other for a loan. In fact the rate of interest in each place is settled by the demand and supply of loanable capital in that place. This, however, is itself partly affected by the demand and supply elsewhere. When the demand falls or the supply increases in England, some of it is attracted to Australia, otherwise the difference in the rates of interest would not perhaps have sufficed to overcome what Mr. Walker calls "the disinclination of capital to emigrate." With increasing communication this "disinclination" is steadily diminishing, and consequently the differences in the rate of interest obtainable in different parts of the world are becoming less.

Loans are of course required for very different sorts of purposes. The spendthrift borrows to increase his means of consumption; the manufacturer to increase his means of production. States borrow sometimes for military purposes, sometimes in order to develop the resources of the country. So too there is some variety in the motives which induce lenders to lend. Friendship, family feeling, the desire to promote some worthy object, may be mentioned among these. But Political Economy begins by considering investments of capital as simply made from the desire for profit and for security. From the point of view of those lending from such motives, the purpose for which the capital is required

Different  
causes of  
Loans,

may be neglected. But from the point of view of the general advantage there is of course the widest difference between a loan that is contracted for productive, and one that is contracted for unproductive purposes. A national debt incurred by engaging in a useless war is a distinct injury to the community. It must always be borne in mind that interest has to be paid out of the produce of labour. It is a clear deduction from that produce. The producers of wealth, including employers and employed under the term, get for their labour not its whole produce, but its produce *minus* what has to be paid for rent and for interest.

But if the national debt has been incurred for productive purposes, the increase in the annual produce may exceed what has to be paid annually as interest, and in that case, though the producers have to pay the interest, they receive more than an equivalent from the increased produce of their labour. It is by no means easy to say how far interest should be regarded as causing a reduction of wages. It all depends on whether the capital (for which that interest is paid) is adding to the annual production of labour by an amount equivalent to the interest.

It would be beyond the scope of this book to explain the actual ways in which capital is borrowed in modern industrialism, but it may be necessary to warn the student that the fluctuations of interest and discount in the money market depend partly on causes of a very different kind from those spoken of in this chapter. What a man of business really wants to borrow is not money but capital. He wants perhaps to enlarge his business, to build a new

and different effects.

Interest a deduction from produce.

But the producers may continue receiving more than an equivalent.

The mechanism of the money market affects this rate.

factory, to add to the number of his machines or to the quantity of his stock. The money is simply the means by which he gets new tools or materials. But the mechanism of money and credit introduces new elements which considerably affect the rate at which capital can be borrowed. To a superficial observer it might even seem that the arbitrary decision of the Bank directors exercises in England a preponderating influence in determining the terms on which persons of approved security can get loans from bankers. In reality the ultimate determining forces are, however, the supply and demand of loanable capital, and the Bank directors in fixing the rate of discount fix it so as approximately to equalise these.

#### SUPPLEMENTARY READING.

MILL, Book II. Chap. xv.; Book III. Chap. xxiii.; Book IV. Chaps. iv. and v.

MARSHALL, Book VI. Chap. vi.

#### QUESTIONS.

1. "A manufacturer (in estimating his capital) may include some land, and also his business connection, but neither of these should be included in the capital of the community."

Explain and discuss this statement.

*Is there any distinction, from the manufacturer's point of view, between the rent he pays for land and that for the buildings on it? Does his "business connection" mean that other manufacturers sell less than they would otherwise have done?*

2. Account as well as you can for the rates of interest in England, Turkey, and Australia.

*Distinguish between nominal and real rates. Remember that industrial qualities constitute a demand for capital. Show how the disinclination of capital to emigrate operates.*

3. What connection is there between the rate of interest and the price of land bearing a given rental?

*People sometimes buy land merely as an investment. Remember the tendency of rents to rise.*



## CHAPTER VI.

### WAGES.

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#### SECTION A.

#### THE REMUNERATION OF LABOUR.

It will be convenient to begin by including under **Wages** all kinds of remuneration for *productive* work. In ordinary parlance we speak of a butler's "wages," although Use of word "Wages." he is not a productive labourer. On the other hand, we speak of a manager's "salary," and we include the remuneration which an employer gets for his labour under the word "profits," which also covers the interest he gets for his capital. There is no word in the English language which exactly corresponds with the idea we want to express; and we prefer to take the word "wages" rather than coin a new term.

We have seen that every year a certain amount of wealth is produced in a nation. Out of that produce a certain amount is paid to landlords as rent, and a certain amount to capitalists as interest. What is left after rent and interest are paid, What remains goes as remuneration to those who have been engaged in production. No doubt there are certain minor deductions to be made, such as the amount paid in taxes for the services

which the Government renders. But we may neglect these without affecting the general truth of the above assertions. Many taxes aid production by giving security to producers, or in other ways. These may be included under the expenses of production, and the net produce available for Rent, Interest, and Remuneration is that left after these and all the other expenses of production have been defrayed. It is the addition made to the existing stock of commodities that is divided among landlords, capitalists, and productive workers; and those taxes that aid or protect production may legitimately be accounted as charges that have to be met before the distribution of the remaining produce. Taxes which do not fall under the above description must be considered as forms of expenditure differing from ordinary forms of consumption, simply in being compulsory. This difference is no doubt important. A man's contribution to the poor-rate cannot be regarded as similar in character to his voluntary charities. Nevertheless for our present purpose we may consider the remuneration of labour as being approximately the residue of the Net Produce, after Rent and Interest have been paid.

though some taxes are compulsory forms of expenditure.

Important results follow from this way of looking at the matter, and in particular it must be noticed that the total remuneration of labour can only be increased, either by increasing the net produce of labour, or by diminishing the amount that goes to landlords or to capitalists as Rent or Interest. So long as competition is moderately free, it would be idle to expect that in any progressive society the amount paid in rent will diminish. In such a society the tendency is for rents to increase, and although the

Only three ways of increasing the Wages Fund.

rate of interest is likely to diminish, it is probable that Capital will increase so rapidly as to make the total amount paid in interest a constantly growing sum. In these circumstances it is chiefly to an increase in the Net Produce that we must look for increasing the remuneration of labour.

It must further be remembered that an increase in the *total* remuneration of labour is not inconsistent with a fall in the average remuneration. The number of workers amongst whom the amount has to be distributed needs also to be considered, and for average remuneration to rise, the total remuneration must increase more rapidly than the population.

Again, it must be noticed that an increase in the Net Produce will not necessarily raise the share obtained by any one of the parties to the distribution. Whether it does so will depend on many considerations. It nevertheless seems probable that improvements in production will to some extent benefit the workers as a whole. Let us next suppose that the amount available for the remuneration of labour is determined. It still remains to ask how this will be distributed among the different classes of workers; the relative shares that can be secured by different kinds of ability, the proportions of the "wages" of Employers and Employed. It is this last problem that we shall mainly be concerned with in the remaining sections of this chapter.

## SECTION B.

## WAGES OF ABILITY.

The remuneration secured by natural ability bears a certain analogy to rent. It is of the nature of an excess. Suppose that two farmers are applying for a farm, and that one of them by his superior ability or industry could make £100 a year more out of it than the other. Will the landlord be able to get more rent from him? No doubt in certain circumstances he could. If all the land in the district were owned by one man, an exorbitant rent could be secured from a farmer who was reluctant to go into any other district. But when competition is tolerably free, the competition of landlords would prevent this. If the rent were such as Ricardo's law would account for, it would be the same for each farmer, and the more skilful would receive, as remuneration for his superior skill, the whole of the extra produce it created. The same thing holds (normally) of hired workmen. Take two men, the difference of whose skill is represented by £1 a week. If it pays an employer to give £2 a week to the less skilful, it will pay him just as well to give £3 a week to the more skilful. The employers might of course combine to prevent any man in the trade earning more than 50s. a week; just as the employed might combine to secure a minimum of 45s. But if we ignore such combinations we see that the competition of employers will secure for our skilful workman just £1 a week more than the other gets. If he offered his labour at 55s. every one would prefer him to his rival at 40s., and he would soon find that he could secure better terms.

Similarly, in the case of employers, we find that the skilful can secure for himself the whole produce of his superior skill. Take a man who is earning £10,000 a year, besides the normal interest on his capital. His workmen perhaps grumble that he gets this large income out of *their* toil, yet they would perhaps find that this man pays as high, or higher, wages than one who is only earning £1000 a year for his work of superintendence and direction. The extra £9000 a year represents his extra skill. Of course there are men who get large fortunes by cutting wages down to the lowest point, but, as a rule, it will be found that successful employers pay at least as high wages as the less successful. It may indeed be asked why this particular kind of ability should receive so high a remuneration. To write a great poem is a nobler achievement than to judge correctly when and where to buy, when and where to sell, or whom to employ, and at what wages. But the exchange value of ability bears no proportion to its nobility, nor even to its utility; and our present concern is with what men *can* earn, not with what they *should*. But, secondly, it is to be noticed that a distinction should be made between natural and acquired ability. The former is like land, of the nature of a monopoly; the latter is like capital, partly produced according to the demand for it. A clerk with a good knowledge of French is able, let us say, to earn £20 a year more than a similar man who knows no language but his own. So far as French is learnt merely for its commercial value, the number of clerks who know French will be determined by the comparison of £20 a year with the time and expense which will be involved in learning the language; and as education spreads, the remuneration for a knowledge

of French will certainly diminish, unless there has simultaneously taken place an increased demand for this attainment. In an ill-educated nation the ability to read and write may be highly remunerated; but it receives no remuneration at all when all men have had a fairly good elementary education. As society progresses, the remuneration for unusual natural ability (of the industrial sort) is likely to rise, for the demand for it will increase with the complexity of society, the extension of markets, and the invention of new processes. On the other hand, the remuneration for acquired ability is likely to fall, owing to the fact that the supply of it is likely to increase. Thus we find a fresh analogy of natural ability to rent, and of acquired ability to interest.

### SECTION C.

#### • WAGES OF EMPLOYERS.

The rather clumsy title of this section will help to remind the reader of the sense in which we are using the word "wages." The student will do well at this point to return to the analysis we made in Chapter III. of the functions of employers in modern industry. It is difficult to over-estimate these functions. Not only does the employer generally take the risk involved in all industrial processes, it is also to him that the *initiative* in business generally belongs. In what we called times of bad trade, or depression, there is the old amount of land; there is often a more than usually great supply of capital seeking employment; of labour, too, there is an excess; but though there is land, labour, and capital in abundance, there seems some impediment to their employ-

ment: they are like the enchanted people in the fairy tale, who had to wait for the touch of a fairy wand before they could discharge their ordinary functions. The shrewd hard-headed employer does not seem a very fairy-like personage. Yet it is for him that land, labour, and capital are waiting. The period of depression is often simply a period when the employing class have for some reason lost the courage and enterprise which usually characterise them. They have probably been frightened by a number of commercial failures, and so trade is temporarily paralysed. Gradually, however, courage and enterprise revive, and, as at a touch of the fairy wand, labour, capital, and land are brought into the needed co-operation by the intervention of the employing class. It is natural that the ablest members of a class which plays so important a part in business, should be able to secure large "wages." Of people willing to be employers there is never likely to be a lack, but those who can wisely judge what the community needs, and how its needs are best to be supplied, are usually few in number. These men can generally secure a high remuneration for their work, and this remuneration is not obtained (as is sometimes thought) at the expense of labour. We imagined in Chapter III. the case of two employers, one of whom got £1650 a year for his labour, and the other only £50 a year. We said that there was no reason to suppose that the former paid lower wages than the latter; that in fact the probability was the other way. Moreover, the employes of the successful man are far more likely to have regular employment. The other will fail when he is unfortunate, or will choose to become a salaried official. His men will be turned off, and will perhaps be some time without wages at all, and perhaps have to travel

in search of work, or be otherwise inconvenienced. Thus even with equal wages it would be better for the workmen to be under a successful employer; while the probability is that the wages paid by such a one will be somewhat higher, or at least that he will be less likely to adopt petty economies of the kind that in the long-run are the reverse of economical. On the whole, then, there seems little reason to grudge the high earnings of the successful men of business, taken as a class. These earnings are mainly a form of remuneration for natural ability. They are therefore of the nature of an excess, corresponding to the increased wealth produced by exceptional skill.

If the earnings of some employers are exceptionally high, it must next be noticed that others earn exceptionally low remuneration for their labour. In saying this we of course compare their earnings with those of men of like ability and attainments, who are not conducting business on their own account. Some employers make, as profits, little more than what their capital would obtain in the shape of interest if it were invested in somebody else's business. These men practically get *nothing* as "wages." Others get less than nothing. Their business drags along, and in spite of constant labour their capital is diminishing, or they get less than the normal interest on it. In estimating employers' "wages" we have of course to include the successful and the unsuccessful.

It is not easy to say how far the amount earned by an employer depends on the amount of capital he possesses. A large business needs a large capital, and if the profits made in it are at all proportional to the capital, it is obvious that the employer's "wages" are much higher where the business is large. Thus suppose two men conducting business with



capitals of £5000 and £20,000 respectively. Suppose the profits in each case are at the rate of ten per cent., while the rate of interest is only four per cent. The "wages" of the first employer is only £300 a year, while that of the second is £1200. But this difference of "wage" mainly represents the greater ability required to conduct the larger business. If the first of our employers were competent to make ten per cent. profits on a capital of £20,000, he would probably find little difficulty in borrowing £15,000, if not at four per cent., at least at five, or six, or seven. The difficulties in the way of borrowing, and the additional sense of security with which a large capitalist inspires those he deals with, must no doubt count for something. And again, if a man begins with little or no capital some time must elapse before he can convince bankers and other lenders of his ability to manage successfully. Nevertheless, on the whole, and in the long-run, it is probable that the difference between the "wages" of different employers mainly represents a difference of ability (or good fortune) rather than the difference of capital, except perhaps in the early years of a man's business career.

### SECTION D.

#### WAGES OF THE EMPLOYED.

What are the forces which determine the wages of the great mass of the people,—of those who are often spoken of as the working classes? This is perhaps the most important question in Political Economy, and it is one of the most difficult to answer. I shall begin this section by a brief criticism of some popular theories on the subject, theories which have

obtained sanction and support from eminent writers, but which seem to me to be thoroughly fallacious.

I. THE WAGES FUND THEORY.—This theory was adopted by Mr. Mill in his great work on Political Economy. Mr. Mill subsequently admitted that it was erroneous, but neither he nor his fellows seem to have realised how completely this theory was interwoven with his whole doctrine of Labour and Capital, of Profits and Wages. This theory implies that the average rate of wages depends on the proportion between capital and population; or, to speak more accurately, between that portion of capital which is available for wage-paying and that portion of the population which is earning wages. There is a sense, no doubt, in which the Wages Fund theory is not only true, but even axiomatic. If we define the Wage Fund as the sum-total of what is paid in wages, it is obvious that we arrive at the average wages by dividing this fund into as many parts as there are wage-earners. To any one who understands the meaning of averages it will be clear that this is only another way of saying that people are paid what they are paid. But the Wages Fund theory which has disfigured much of English Political Economy implies far more than this. It implies that a mere increase in the number of wage-earners necessarily lowers wages, unless there has been a simultaneous increase of capital; that when, for instance, the Huguenot refugees landed in England, their coming necessarily lowered English wages, unless they brought with them funds sufficient to pay their own wages! And yet a moment's thought will show that if these Huguenots produced more than they consumed, they may have not only avoided

Erroneous  
theories—  
I. Wages  
Fund.

In what  
sense true.

In what  
sense false.

trenching on the wages of Englishmen, but even have added to those wages. This at once suggests that the wages which people earn are paid ultimately out of the produce of their labour, and not out of a sum that existed before their labour began. Another illustration will make the matter still clearer. A man suddenly becomes possessed of large slate quarries where 10,000 men are employed at wages averaging £2 a week. It is Monday (we will suppose), and he knows that on Saturday he will have to pay £20,000 in wages. Perhaps he has nothing beyond the quarries. Must he borrow enough to make the payment? Not necessarily. If he can sell the slate quickly for ready money he will probably have enough, when Saturday comes round, to pay what he owes. For if the quarries are bringing in a profit, the average weekly sales must exceed the average weekly payments. Where then is the Wage Fund from which these 10,000 men are paid? On the Monday it is in the form of slate, to which the men's labour will add a value. Upon our assumption they will, strictly speaking, be paid out of the produce of their labour.

And indeed, when we come to examine into the matter, we discover that this is the normal principle. An employer is hesitating whether to engage a man at a wage of £1 a week. The fundamental question that he asks himself is, "Will this man's labour be worth £1 a week to me? will he produce that, and enough more to remunerate me?" The employer has perhaps to pay rent, taxes, and interest; he has to get his own "wages"; and, lastly, he has to pay the wages of those he employs. These, as we have seen, all come out of the Produce, and their joint amount must be determined by the value of that Produce. Thus the produce of a man's labour supplies us with a maximum which his wages cannot

normally exceed. How far they fall short of it depends on many circumstances which we have partly considered in former chapters, and which we shall partly consider hereafter. Do we then affirm that the amount paid during the year in wages does not in any way depend on the amount of capital existing at the beginning of the year? By no means. But our charge against the advocates of the Wage Fund theory is that they direct our attention to just that portion of capital which has least to do with the matter.

Capital may conveniently be divided into *auxiliary* and *remunerative*. Under the former we include all machinery, tools, materials, etc.; under the latter we refer to the fund which enables employers to take the risks of industrialism, and to advance the means of subsistence to labourers in a form that will meet their needs. This latter is usually called the Wages Fund. Its existence is a great convenience to the labouring classes, especially to those among them who do not possess the means of subsistence, and cannot afford to wait till the produce of their labour has been exchanged for the things that the labourers need. The labouring classes ultimately pay for this convenience, for their wages are somewhat less than they would be if they could afford to wait and run the risk; but this fund in no way measures the amount of wages they receive. On the other hand, the auxiliary capital (which the writers we are speaking of exclude from the Wages Fund) does really cause an addition to wages so far as it increases the produce by more than the interest charged for its use and the extra remuneration which the employers can secure. There

Auxiliary  
Capital.

Remunera-  
tive Capital.

The latter a  
convenience,

for which  
labourers  
pay;

but the  
former has  
more effect  
on the  
amount of  
wages paid.

is indeed no fixed proportion between Capital and Wages with a given population, but the amount of auxiliary capital does affect the amount paid in wages; while the amount of remunerative capital—of the so-called Wages Fund—has scarcely anything to do with the matter, except so far as it helps to keep the labourers in health and strength, and so increases the produce of their labour.

II. THE NECESSARY WAGE THEORY, which we will next examine, has at present more popularity than the one we have spoken of. It is, in effect, that there is a constant tendency for the wages of the great body of unskilled labourers to sink to a point which barely suffices to sustain life. This is the so-called “*iron law of wages*” which Marx, Lassalle, and other Socialist writers have familiarised us with. But it has also been put forward by Ricardo and other writers strongly opposed to Socialism. It has the advantage of seeming to account for the persistence of poverty among the masses, in spite of the great increase of national wealth. But when

Second  
erroneous  
theory.

What wages  
are neces-  
sary?

we come to analyse the phrase “necessary wages,” we find ourselves in the midst of ambiguities. What wages are necessary? If by “necessary” we mean necessary for full health and strength, necessary for giving a fair chance for as long a life as comfort would ensure, it is obvious that the masses in England and elsewhere do not obtain such wages. The “Law of Wages,” whatever it is, so far from tending to force wages down to this point, evidently keeps them, in all communities we are acquainted with, very far below it. Again, shall we interpret the phrase as necessary for bare existence? An appeal to facts disposes equally of the theory thus interpreted. Englishmen

between 1815 and 1848 presumably earned enough for bare existence; but if we assume that the rate of wages during the period between the great war and the abolition of the Corn Laws was up to the "necessary" rate, it is certain that at the present day it is considerably above it. Bare existence seems a definite enough idea, yet it is certain that some people manage to live on what leaves others an easy prey to death. Is the necessary wage what is necessary for a bachelor, or what is necessary for a married man with a large family? At every attempt to analyse the "bare-existence" interpretation we are met with fresh difficulties, and we find it no more tenable than what we may call the "comfortable-existence" interpretation. Another interpretation *might* be given, but it is in itself so important, and so ill described by the phrase "necessary wage," that we shall deal with it as a distinct theory of wages.

III. THE STANDARD OF COMFORT THEORY.—This theory resembles the last, but it rests on the idea that all or most men have in their minds a certain standard of comfort, for themselves and their families, which they will resolutely aim at keeping up. Wages, on this theory, tend to sink, not to what is objectively "necessary" for bare existence or comfortable existence, but to the amount that will just enable the wage-earners to keep up their customary standard of comfort. It might seem a sufficient answer to point out that the customary standard of comfort is a *result* of the amount of wages earned. Agricultural labourers in a certain village earn on an average 15s. a week. They have a customary standard of comfort. This involves, let us say, a four-roomed cottage, bacon once a week, a certain amount

Third erroneous theory.

Standard of comfort an effect rather than a cause of wages.

of beer and tobacco, a certain quantity and quality of food and clothing for the man, for his wife, and for his children. Whence comes this standard? Plainly from the fact that his wages are 15s. a week, and that this allows of such cottages, food, clothing, tobacco, etc. It seems absurd to say that he gets 15s. a week because he has this standard of comfort, when we know that he has this standard of comfort because he and others like him have been in the habit of getting 15s.

**What truth there is in the theory.** a week. Nevertheless there is, I think, *some* truth in the statement. The man may be so attached to this standard that sooner than accept less he will leave the village. This determination may be so

**Strong,** that the farmer will submit to lower profits, or hold out for a lower rent, sooner than lose the services of the man. In the long-run, no doubt, farmers' earnings and rents tend to normal amounts. They will not permanently fall far below what they would be if the labourers were less resolute. But

**Temporary effects.** for a time, no doubt, the determined stand for wages that will enable a man to keep up his standard of comfort may be effective. Again, it is held by

many that the labourer's power to abstain from marriage and the propagation of children puts into his hand a powerful means of keeping up his standard of comfort. In one sense

**Effect on marriage and procreation.** this is certainly true, viz., that the individual labourer may enjoy a higher standard of comfort by delaying marriage, or otherwise limiting the

size of his family. But this fact does not help the theory we are examining. It only reminds us that with smaller families any standard of comfort can be kept up upon somewhat lower wages. Something more than this is needed to show that wages depend in any way on the standard of subsistence.

It must be shown that a diminution in the number of wage-earners tends to prevent wages from falling. Whether this is so will be partly considered in a later chapter, but here we must notice that it is by no means always the case that a lowering of wages is followed by a diminution of births. When the fall in wages is sudden and considerable, it is often found that despair makes men reckless in this as in other matters; and at any rate the effect of abstinence from propagation on the number of wage-earners is not felt till many years after the abstinence; till the children have had time to grow to an age at which they begin to receive wages. On the whole, therefore, there seems only a very small amount of truth in the doctrine that the wages of the unskilled, or of any other class of labourers, depend on their habitual standard of comfort; and certainly it does not supply us with any complete explanation of the amount of wages that can be earned.

### SECTION E.

#### WAGES OF THE EMPLOYED—*Continued.*

It is easier to refute erroneous theories of wages than to propound a true theory on the subject. Indeed, the facts and forces at work are so many and complicated that it may be questioned whether they can be packed into any neat and simple theory. We shall only call attention to a few important points, and not attempt any exhaustive explanation of the rate of wages.

I. *Wages are normally paid out of the produce of labour, and consist of what remains of that produce, after rent, interest, and employers' remuneration have been defrayed.* This is only a fresh statement of an old equation (see page 20). <sup>The real Wages Fund.</sup> Whatever increases the produce of labour in-



creases one or more of the shares, and makes it *possible* that all parties in the distribution may obtain a larger share ; but it is almost impracticable to lay down any general laws as to how the increase will be shared among the claimants. If it is simply due to an increased population, it is possible that the total paid in wages may increase, and yet that the rate of wages should fall. Similarly, if the increased produce is due to an increase of capital, it is possible that the total paid in interest may increase, and yet that the rate of interest may fall.

If the increase in the produce is due to some improvement in the quality or organisation of labour, it is probable that all parties to the distribution will gain ; for such improvements are likely to increase the demand for Land, Labour, and Capital, and therefore to raise the exchange value of each of them.

II. *What concerns the labourer is not his nominal wage* (measured in money) *but his real wage* (measured in commodities). A man would neither gain nor lose by an increase of 10 per cent. in his money wages, if he had to pay an extra 10 per cent. for everything he wanted. This, of course, applies equally to the income of all classes ; and it adds to the difficulty of comparing the condition of any class at two different periods.

It is comparatively easy to estimate a change in nominal wages ; but the changes in prices are of a more complicated character. If the price of meat goes up, and that of agricultural produce falls, the real wages of a meat-eater may be falling, while those of a vegetarian are rising. When we remember how many articles are included in the consumption of most men,

and that the proportion of their amounts varies between each two individuals, the difficulty of an accurate calculation will be seen. Not less important from the worker's point of view is regularity of employment. A man who earns 52s. a week, but is out of work for ten weeks in the year, only gets in money as much as one who earns 42s. all the year round. If he can count, with a fair amount of certainty, on getting 42 weeks' work, his position may be preferable, even if his work is proportionately harder. The advantage of ten weeks' holiday may compensate for the harder work. But if his employment is uncertain, its irregularity will be a most serious disadvantage. Seeking employment may be more harassing and exhausting than actual labour, and the alternations may disorder his life, lead him sometimes into extravagance, and compel him at others to pawn or sell at a heavy loss, or to stint himself and his family, and to thus diminish the efficiency of his labour or theirs.

Irregularity  
of employ-  
ment.

Evils of  
uncertainty.

III. *What concerns the employer is not the nominal wage he pays (as measured by time), but the real wage he pays (as compared with the produce of the labourer's work).*

Real wage  
from em-  
ployers' point  
of view.

Thus the "real wage" differs according to whether we look at it from the point of view of employer or employed. If five English labourers can do as much work as six French ones, it is as cheap to pay 6s. a day to an Englishman as 5s. a day to a Frenchman.

Lowering of  
wages not  
always a  
gain to  
employers.

It follows from this principle that what are low wages to the employed may be high wages to the employer, if the labour given for them is inefficient; and as efficiency depends in some measure on the food,

clothing, housing, etc., of the working classes, it by no means follows that a lowering of wages is a gain to the employers. Underpaid labour is, in fact, generally dear at the price.

IV. *There is a constant tendency to equality in the wages of any two occupations which are practically open to the same class of*

*Equalising tendencies between similar employments.* *persons, and which need about the same amount of physical, moral, and intellectual qualities, and are subject to equal disadvantages.* In estimating the net advantages, it is necessary to consider the

attractiveness of the work, the risks, and other disagreeables involved, the constancy of employment, and other similar things. Let us suppose that the net advantages of a carpenter's work are about equal to those of a builder, and that the qualities and the education required are nearly equal, but that carpenters are the more highly paid. It will not be easy for builders to turn into carpenters. A few of them might do so, but in the case of most, the difficulty and expense of learning a new trade, and getting up a new connection, would be a sufficient hindrance. Nevertheless, there will always be a certain number of young men choosing a trade who will be attracted into the one where the remuneration is higher. There is a tendency for young men to follow their father's trade, but there will always be many who are

*How the equalisation is brought about.* *under no strong motives to prefer either occupation, and these will provide a number ready to flow into one trade or the other according to the remuneration they offer.* In our illustration, such youths will be attracted to carpentering, and the increased supply of labour will bring down the wages in that trade. A corresponding tendency will raise the wages of builders, and the process will continue till the wages are brought to a tolerable

equality. Where the net advantages are different, men will estimate differently the difference of wages necessary to make two trades equally attractive. The builder is more likely than the carpenter to be out of work during the winter; and even if the annual remuneration is the same for the same number of hours' work, the irregularity of employment will probably seem to most men a disadvantage; but some will prefer the unequal distribution of leisure. A similar remark applies to other differences in the attractiveness of different occupations.

*V. People who begin life in different social positions do not compete with one another for employment to any great extent.*

We are all familiar with the great differences of remuneration in different employments—differences which, in many cases, cannot be accounted for by the difference in the attractiveness of the work, or in the ability required for it. This will not surprise us when we realise to how large an extent different classes of workers are drawn from non-competing groups. We have spoken of lads hesitating whether to enter the builder's or carpenter's trade, and determined partly by the difference in the rate of wages. We have seen that the existence of such lads helps to equalise the remuneration in trades of the same social level. But there are practically no lads hesitating whether to be doctors or agricultural labourers, and there are practi- Non-competing groups.  
cally no forces at work tending to equalise the net advantages of such occupations. The same thing applies to some extent to classes which are separated by no such gulf. Society is split up into non-competing groups, each of which, in the main, has to bear its fate alone. The rate of wages in each is that which equalises the demand for its

particular kind of labour, with the supply of such labour in the market, and the supply is not much affected (except within the group itself) by the expected remuneration.

VI. *The tendency of competition to equalise wages for work of any given grade, and net advantages, is often defeated by the immobility of labour.* There are great difficulties in the way of men moving from one place to another, or one occupation to another, when such movements would be economically desirable. These difficulties are even greater in the case of women. Among them, the difficulties of moving from place to place, ignorance, sentiment, and expense may be specially mentioned. The expense of moving would often be speedily covered by the better wages obtainable elsewhere, but the labourer whose wages have fallen is often in no position to defray the preliminary expense. It is often difficult for him to obtain adequate information as to the demand for labour and the remuneration it can secure in other districts than his own; and he is often restrained by sentiments, some of which are honourable to him, from leaving a familiar locality, where he has friends and relations around him, and memories that bind him to the spot. The difficulties in the way of passing from one occupation to another are, in most cases at least, as serious; and even the lad who has not yet entered a trade is often very strongly biassed to enter his father's occupation. The wages in it may be lower than in others of the same grade and net advantages, but for him the entry into it is far easier, and though he may be acquainted with its disadvantages, he would rather face them than risk others that he knows not of. Nor must it be supposed that these difficulties are of a temporary kind, which only somewhat delay the readjustment of wages. For

Immobility  
not merely a  
temporary  
check.

if, from any cause, the remuneration of any kind of labour, in any locality, has fallen, the delay to move to another place, or another trade, is likely to be followed by a permanent degradation, through loss of efficiency, especially if the occupation was one in which the wages before the fall were little more than sufficient to provide the bare necessities of life. "With less food, which is the fuel of the human machine, less force will be generated; with less clothing more force will be wasted by cold; with scantier and meaner quarters, a fouler air and diminished access to the light will prevent the food from being duly digested in the stomach, and the blood from being duly oxydised in the lungs; will lower the tone of the system, and expose the subject increasingly to the ravages of disease."

The underpaid labourer thus loses his efficiency. He is in fact not underpaid from the employer's point of view, for his work is not worth more than it secures. It is in this way, and this way only, that the "equalising" force of competition works when any sudden change lowers the remuneration of any particular kind of labour, unless those engaged in it have sufficient energy, determination, and means, to move into some more favourable trade or locality. The law, in such cases, ceases to be a beneficent one. It simply points to a degradation terrible to contemplate, and of which modern industrial history gives too many examples.

Equalisation  
through  
degradation.

If we view the industry of a nation as a whole, and ignore changes in population, we see that there are two main ways in which wages might conceivably be raised. If the Produce of labour is increased, it is possible that all parties to the division may obtain a greater share, and thus that wages

may increase. Or, secondly, it is conceivable that while the Produce remains the same (or is even diminished) the wage-earners might gain higher wages at the expense of the other parties who claim a share in it. To any suggested remedies for (general) low wages we may therefore apply the question: Will it increase the produce of labour? and, if not, at whose expense will the rise be?

VII. The relation of Wages to Population does not admit of any general definition, but it is probably the case that

**Wages and Population.** *an increase of population generally lowers wages unless it be accompanied by an increase of Capital.*

We saw, under the head of Production, that an increase of population in an industrial community is generally followed by a proportional, or more than proportional, increase in Production, but such an increase will generally lead to a rise in rents, and in the rate of interest, unless there is a corresponding increase in Capital. That rents will rise if the population increases, and other things remain the same, has been shown above; and the rise in the rate of interest follows from the fact that the demand for Capital will naturally be increased by the increase of population. Employers' remuneration will also probably increase, since there will be a greater demand for business ability, and there will be little change in the supply if the increase of population has been in the labouring class. Thus it is highly probable that, with an increase in the proportionate produce, the share obtained by the wage-earning class will not be proportionally great, and therefore that the average rate of wages will fall. The same conclusion is suggested by viewing the question from the point of view of the demand and supply of labour. The supply of labour is on our

assumption increased. No doubt there is also an increase in the demand. For each addition to the working population creates a demand for labour, by offering products in exchange for those of others; but the increased demand is probably not enough to balance the increased supply at the old remuneration, and therefore wages will probably fall. This conclusion, however, is not capable of proof. It amounts, at most, to a strong probability. Those who advocate prudence and self-restraint in the matter of increasing the population would be wise to confine themselves mainly to the unquestionable fact that wages which will support a small family in comfort will not keep a large one out of abject poverty. So long as the children are non-producers, it is evident that they are economically a loss, since they in no way replace what they consume; and in the case of the very poor, large families must often lead to the loss of efficiency (and consequently of wages), which was referred to in the last section.

Increased  
population  
does not  
necessarily  
lower  
wages

VIII. *While Population and Capital are stationary, an increase in general wages can be obtained only by increasing the annual Produce of Labour and Capital; or by diminishing the amount that goes to Rent, Interest, or Employers' Remuneration.* This follows at once from the equation of Distribution. The Produce is divided into four parts, and if it remains constant no part can be increased, except at the expense of one or more of the others. It is difficult to see how the wage-earners can hope perceptibly and permanently to secure for themselves a larger share of a fixed produce at the expense of either Rent, Interest, or Profits. For economic rent represents the

Difficulty  
of raising  
wages at  
expense of  
rent.



differences in utility or convenience that exist between different portions of the earth's surface which it pays men to use. Law or custom may determine who gets all or part of this, but, as we saw in Chapter IV., it can in no way be converted into Wages. Again, Interest is the price paid for the use of Capital, and is determined by the supply and demand of loanable capital. The resolute action of wage-earners might affect the demand for capital, but the consequent fall of Interest would probably affect the supply, especially by causing much capital to emigrate. This would probably diminish the produce, the fund out of which wages come. It is most improbable that the wage-earning class can gain anything by discouraging the accumulation of capital. The only way in which they are likely to profit by a fall in the rate of interest is when that fall is due to an increased supply of capital, through an increase in thrift, or in that produce which measures the power of saving. Lastly, it is difficult for wage-earners to gain by diminishing employers' remuneration. It must be remembered that many employers get as profits little or nothing beyond the current rate of interest on the capital they have invested, and some get even less than this. The honest profits of the successful man of business represent his superior skill or good fortune. They are not made, strictly speaking, at the expense of his employes, since he probably pays at least as high wages as his less successful rivals. To drive him from the field, or to induce him to retire from business and to live on his interest, would be the reverse of a gain to the working classes. It must also be remembered that the initiative in modern industrialism lies with the employing classes. It is the employers who set capital and

labour to work, and any considerable diminution in their remuneration tends to paralyse industry, and to swell the number of the unemployed. On the whole, then, we conclude that under the existing organisation of industry, the best hope of raising wages, with a given population, lies in increasing the productiveness of labour and capital, or in increasing the amount of capital productively employed.

### SUPPLEMENTARY READING.

MARSHALL, Book VI. Chaps. i. to v. ; xi., xii.

### QUESTIONS.

1. What determines the amount available in any community for the remuneration of labour?

*Analyse each term in the equation of Distribution.*

2. Indicate some of the chief causes of the amount of remuneration obtained for their labour by (1) miners, (2) lace-designers, (3) professional cricketers, (4) large employers of labour.

*Consider in each case from what social level the occupation is recruited, and then indicate net advantages and requirements, as compared with other occupations on the same level.*

3. Consider whether wages would be increased by—

(1) A successful system of technical education.

(2) The disuse of alcoholic drinks.

(3) The nationalisation of land.

*The effect on Production and that on Distribution must be considered.*

4. Explain the phrases "immobility of labour" and "standard of comfort," and show how the facts they point to affect the wages' question.

5. Consider briefly the economic effects of a poor law which secures that no one need starve.

*Notice effects on thrift and industry. Explain the principles on which you think such a poor law should be based. Should out-door relief be given to supplement low wages? Who should bear the burden?*

6. Discuss the way in which the progress of civilisation is likely to affect the profits of employers.

*Distinguish between the tendencies of "interest" and of employers' "remuneration." Show the tendencies of increase in population, improved intercommunication, inventions, spread of education, etc.*

7. "Many manufacturers admit that if they could get two sets of men to work their machinery for eight hours a day each, they could afford to pay the men as high daily wages for the eight hours' work as they now pay for ten hours, and yet make a better profit."

Show the reasonableness of this. To what kinds of trade should you think this "shift" system most applicable? Indicate any of its advantages and disadvantages.

*Consider what has to be paid out of the produce of labour, and apply the result to each system in turn. Notice social as well as economic effects of the system, stating what hours you would assign to each set of men. They might change about in alternate weeks.*

## CHAPTER VII.

### TRADES UNIONS AND CO-OPERATION.

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#### SECTION A.

#### TRADES UNIONS.

AMONG the many means by which the working classes have sought to secure more remuneration for their labour, the two mentioned at the head of this chapter seem to deserve a special consideration on account of the extent to which the movements represented by them have spread, and the degree of success they have achieved.

Trades Unions are organisations by which labourers engaged in any particular kind of work seek to promote their common interests. Their objects may generally be classed under three heads.

1. *Trades Unions seek to provide the benefits of insurance against losses caused by sickness, slackness of work, etc.; and other advantages of benefit societies.*

There are obvious advantages in having such societies limited to single trades. A man in any trade is generally known to some others in the same. A society limited to members of a particular trade can consequently get on without much of the advertising and agency expenses which must be incurred by societies which

are not thus limited. The mutual knowledge of the members secures also a comparative immunity from fraud. This branch of the work of Trades Unions is generally approved of, even by the most hostile critics of these organisations, and it is right to notice how large a portion of the work of Unions is included under this head.

During the twelve years from 1892 to 1903 the hundred principal Unions paid more than fifteen and a quarter million of pounds in general benefits, against only three and a quarter million in strike benefits.

In other years the large societies have expended their funds in a somewhat similar proportion, so that if we measure their work by their expenditure, we shall regard this first branch of their labour as the most important; but we must nevertheless pass on to the consideration of those functions of Trades Unions whose advantages are more open to dispute.

2. *Trades Unions seek to keep up and to raise the wages in their trade.*

If we compare the wages of unionists at the present day with those earned by artisans before the days of Trades Unions, or with those earned now in trades where there are no Unions, we see *prima-facie* reason for believing that no small success has been attained by these bodies in raising wages. Other explanations may indeed help to explain the differences, but there is strong reason to think that 'Unionism has to be partly credited with

the result. It is obvious that men acting in combination are more likely to secure the full remuneration which the conditions of the trade allow than the same men would be if they acted separately, competing with

*A priori*  
evidence.

one another without restraint, for employment. They may often accelerate a rise in wages which would otherwise be delayed; or delay a fall which would otherwise have taken place. But it must be remembered that in the main, and in the long-run, wages are determined by quite other forces than a resolute insisting on a minimum of remuneration. The produce of labour and capital supplies, as we have seen, the rent paid for gifts of nature, the interest on the capital used, the remuneration of employers, and the wages of the employed. If the produce remains constant in quantity and price, an advance of wages can only be obtained at the expense of rent, interest, or profits. It is difficult to reduce any of these items. For if interest falls, capital may flow abroad, or cease to be accumulated to the old extent, and the diminution of the supply of capital will force back the rate of interest; again, if the rise of wages be at the expense of profits, business ability will be driven out of the field. Some competent employers will emigrate, or retire from business, and the diminished supply of business ability will raise the remuneration of what remains, and force profits back. Rent, on the other hand, represents *differences* of natural advantages, and can scarcely be forced down by the insistence of the employed on higher wages. There only remain two possibilities, (1) to increase the produce, (2) to raise its price so as to protect all parties in its production from suffering any loss. The former method may unquestionably result in a rise of wages, but it is beside our present question. It only therefore remains to ask whether a rise in price, caused by the insistence of the employed on higher wages, can be sustained. In some cases this must plainly be answered in the negative. If the rise in price enables some

Difficulties  
in raising  
wages.

foreign competitor to undersell the home producer,<sup>1</sup> the rise cannot be sustained, and, in fact, the trade may be ruined. In other cases the possibility of maintaining the rise depends on whether the net advantages of that trade were previously lower than those in other trades of the same social level, and requiring equivalent qualities from those engaged in them. Unless such a difference previously existed there will now be a flow of labour into the trade, and the increased supply of workers in it will gradually force back the wages to their old amount, or, possibly, for a time, even below it. Trades unionists must therefore be careful not to over-estimate their power of affecting wages by combined action. They can do much in keeping their wages up to the normal amount, but very little towards raising them any higher. This fact will become more clear when we have examined some of the rules which Unions have tried to enforce.

3. *Trades Unions seek to organise their trades to the advantage of their members by insisting on certain rules.*

It is scarcely necessary to observe that the advantage of such efforts depends upon whether the rules are good ones or bad ones. Every rule has to be tried on its own merits, and in relation to the circumstances of the trade for which it is proposed. We may notice here that every rule which tends to diminish production is open to the *prima facie* objection that it tends to diminish the fund out of which wages, no less than interest, rent, and profits, have to come. The burden of proof must rest on those who advocate it. They must show that its advantages overbalance the presumption against it. Un-

*Prima facie*  
objection to  
Rules limit-  
ing produc-  
tion.

<sup>1</sup> This part of the argument will be better understood after the student has read the chapters on Price and Foreign Trade.

fortunately, many of the working classes seem to regard the limiting of production as good in itself, and as tending to create employment. They do not seem to see that Production is the end of labour; that a country is poor when it has produced too little, and not when it has produced too much. In particular cases a limitation of production may be desirable. For production in any special department may have been disproportionate, and the goods produced in it may therefore not exchange for what provides a fair remuneration for the workers in that department. But in itself a limitation of production is a disadvantage to the community, and not least to the working classes. Nevertheless, it must be remembered that rules which in the first instance diminish production may in the long-run increase it, especially if they tend to prevent excessive work and inferior workmanship. The rules of some Unions against piece-work—their insistence that work shall be paid by time and not by the amount of work that is done—will serve as a good illustration of this. A workman who is paid by the piece is under a strong temptation to hurry his work, and to do more than it is well for him to do, having regard to his future efficiency. To prevent this system of payment may therefore be a gain, even if it diminishes (for a time at least) the amount done. Again, it must be remembered that a workman's interests are not limited to the amount of his weekly wage. It is important that he should have enough strength left to enable him to enjoy his leisure hours in a rational way; and even if it could be shown that the rule against piece-work diminished his wages, the loss may be more than balanced by the prevention of a mode of payment which leads him to overstrain himself during his hours of work.

Rules against  
payment by  
piece.



The attempt of Unions to fix a minimum of wage for a day's work of given length in their trade, for each district, seems to belong to the second rather than to the third of the heads into which I have divided the objects of Trades Unions. For the main direct way in which these bodies seek to increase the remuneration of their work (time wages) is by combining, so that the individual workman, who is poor and weak, may not have to make terms alone with a rich employer, and so that the workmen may not compete against one another for employment without limit or restraint. This can only be secured by the members of the Union undertaking that they will none of them work for less than a given amount. But some of the indirect consequences of such a rule deserve examination here.

Does the rule keep down the wages of the more efficient? The minimum wage is thought by some to cause a reduction in the remuneration of the abler and more industrious workman. It is argued that because the employer must give the full minimum to the less competent, he cannot afford to give all he would otherwise have given to better workmen. This is not clear. If a man is engaged at the minimum, it is because his employer thinks it will pay him to secure that man's work, even on those terms. The superior efficiency of the more competent is not thereby diminished. He is worth to an employer as much as ever more than his less competent fellow, and, in the long-run, the competition of employers will tend to secure for him the due excess of wages above the minimum. But even if it be granted that the levelling up of the wages of the less efficient involved a levelling down of those of the more efficient, the result would not be one to be deplored, especially when, as in this

case, the loss is voluntarily risked in the interests of the class. At any rate, we do not find that the more efficient members of a trade are disposed to complain of the operation of this rule. It is not they who are wont to stand aloof from the Unions, and to prefer to make their own terms independently with employers. The rule is rather the other way. Non-Unionists are, on an average, and as a rule, less efficient workers than Unionists. The reason of this is sufficiently obvious. A Unionist whose work was not worth the Union minimum to an employer would fare badly under the rule. He would probably be compelled to leave the Society, and accept lower wages than any Unionist might take. There are some such men whose absence is little loss to the Unions; but it is to be regretted that few Unions have seen their way so to modify their rule that members whose inefficiency is due to their age, or bodily defects, should be allowed to work at a proportionately lower wage. With reference to a fixing of a maximum of hours, it may further be noted that most of the considerations referred to in connection with the rules against piece-work have to be borne in mind. Excessive toil is unfavourable in the long-run to efficiency; and even when the hours are not sufficient to defeat the object for which they are prolonged, a rule which protects men against working for more than a given number of hours may have advantages which more than counterbalance the pecuniary loss. After all, wealth is only one element of wellbeing, and the effect of the conditions of ~~work~~ on character and life are at least as important as their effect upon income. Among the means by which Trades Unions strive to benefit their members, we may next mention their

Why inferior workmen are often Non-Unionists.

Rules fixing maximum of hours.

**Rules limiting number of apprentices.** attempts to limit the number of apprentices that may enter their trade. The wise adaptation of the supply of any kind of labour to the probable demand for it is one of the great needs of modern industry. What happens at present is something of this

**Non-adaptation of supply of labour to demand.** sort:—A trade is flourishing; profits and wages in it are above the normal amounts. A stream of capital and labour flows into the trade, and generally continues doing so till the remuneration for them falls considerably below the normal amount. It is difficult for the stream to flow back. Much of the capital is in a form that cannot be transferred without ruinous loss, and the particular kinds of skill which the trade requires are equally difficult to utilise in other trades. If the inflow of skilled labour has been considerable, its wage may fall to the level of that of unskilled labour, or even lower, if the former requires less physical strength than the latter. A change in fashion, the granting of bounties by a foreign government, the invention of new processes, may aggravate or initiate the evil; and skilled artisans may, by no fault of their own, be plunged into extreme poverty, owing to the fact that there are more in any particular trade than the number for which there would be an adequate demand. We cannot, therefore, wonder that the Unions should be jealous of allowing a free admission to their trade. They have generally, however,

**The limitation of apprentices generally carried too far.** carried this jealousy too far, striving to get an artificial advantage by an excessive limitation, by keeping the number of apprentices below what it would be if the probable demand were intelligently estimated. The consequence has been that the apprenticeship system

-has, to a great extent, broken down. Unions have been

compelled to admit as members many who have never served an apprenticeship, and their rules on the subject have achieved little beyond an unnecessary lowering of the standard of workmanship.

## SECTION B.

### CO-OPERATION.

The word "Co-operation" is used for that mode of industrialism under which labourers try to dispense with the employing class. Instead of waiting to be hired, they borrow, or provide the capital necessary for starting a business, and after paying interest on any borrowed capital, divide the profits among themselves in some way previously agreed upon.

Meaning of  
Co-operation.

There are three groups of persons, any one or more of which may, under co-operation, receive a share of the profits. There are (1) those who have provided the capital, (2) those who have been customers to the business, (3) those who have provided the labour. In some co-operative stores each of these parties gets a share in the final division of profits; the capitalists according to the amount they subscribed, the customers according to the amount of their purchases, the workers of every grade according to their wages, or according to some other law. It is more usual, however, to limit the division to the two former of these classes. Under this system nothing is directly done to benefit wage-earners, as such, ~~as far as~~ as far as these wage-earners provide the capital, and deal with the co-operative business, they, of course, derive benefit from the system.

Distribution  
under Co-  
operation.

The advantages of co-operation are many. Assuming that it can hold its own against the system of private employers, it secures for the co-operators what would, under the other system, have been the income of the employer. It also encourages thrift, by providing a convenient and attractive mode of investment for the savings of working men; and when it takes the form of a retail business, it does much to promote their interests as purchasers, since they are themselves at once sellers and buyers. All this goes, however, on the assumption that the business is really a paying concern. Otherwise the investment offered for workmen's savings will not be a good one; the wages offered will very likely have to be less than those which a private employer would give; and even, as customers, the co-operators may suffer and have to pay higher prices for their goods than they need pay at ordinary shops.

**Advantages of co-operation.** The success of co-operation must therefore depend on the question whether it can be made to pay; whether, in other words, the loss of the employer's direction is compensated by the saving of his remuneration, and by the stimulus given to production, or to the sale of the products.

**These depend on the working being economically successful.**

This is mainly a matter that must be settled by experience, and experience has shown that co-operation can successfully be applied to retail business, but that the difficulties of applying it to ordinary productive purposes, render it, for the present, generally unsuitable for them. The success of co-operation when applied to shopkeeping may partly be measured by the following figures. In 1884 there were in the United Kingdom 1284 co-operative societies engaged in retail business. They

**Success in retail trading.**

possessed a capital of over £10,000,000. Their annual sales amounted to over £31,000,000, and their annual profits were nearly £3,000,000. Among the branches of retail trade that are being successfully worked by co-operative societies, grocery, drapery, boot and shoe, coal, butchers, bakers, tailors, furniture and hardware, may be mentioned. It has to be noticed that most of these societies besides offering a good investment for the savings of working men, are also the means of providing better goods than are generally sold at the same price in the retail shops, to which the working classes mostly resort. On the other hand, it must be pointed out that most of these societies do little or nothing towards applying profits directly to the raising of wages. Only in a few of them is a share of the profits distributed among the employés. In the main, those who work in co-operative stores are engaged at fixed wages, similar to what are offered by private employers, and they have no special inducement to industry or honesty, unless they happen to be also shareholders or customers, or to be animated by loyalty to the principles of co-operation.

The failure of co-operation when applied to ordinary productive enterprises has not been universal. In 1884 there were forty<sup>1</sup> co-operative societies engaged in production, with a capital of three-quarters of a million, with annual sales amounting to 1½ millions, and a year's profit of £74,192. These figures are not very encouraging, especially when we consider how many experiments have been made in co-operative production; how much enthusiasm and unpaid labour has been given to

Partial success in production.

<sup>1</sup> This is exclusive of tailoring, baking, and dressmaking, and also of such corn-mills as are carried on in connection with retail societies.

them; how they have been gratuitously advertised by eminent writers, orators, and philanthropists.

The question whether greater success is likely in the future to attend co-operative production is not easy to answer. We have seen what advantages a thoroughly well-managed co-operative business would have over one equally well conducted on the ordinary principles.

In the former, the employer's place would be taken by a manager receiving a fixed salary, presumably far less than the employer's income. The balance would be available (1) to encourage thrift by giving an extra premium on the capital invested, (2) to stimulate industry and honesty in those employed, by giving them a share out of the profits in addition to the wages which they would get elsewhere, (3) to secure a larger business by returning something to all customers proportionately to their purchases.

Such a society ought to have three advantages over the private employer: it ought (1) to borrow capital more easily, (2) to secure better and more faithful workmanship, (3) to secure a larger business. How comes it then that so large a proportion of societies have either failed completely, or secured only a very moderate success? It seems plain that the defect must be in the management. Some co-operators have grudged paying a sufficient salary to attract thoroughly competent managers; and even when the salary has not been inadequate, the manager has not had the stimulus under which an employer works; the stimulus of knowing that he is taking the risk, that he will get all the excess of profit, or have to bear all the loss incurred. There is no theoretical way of determining whether this disadvantage

will be compensated for by the advantages enumerated above; and even where experience has indicated that the balance of gain is against co-operation, it by no means follows that the future may not show more favourable results.<sup>1</sup> The progress of society is favourable to co-operation, at least if it is accompanied by an elevation of men's characters in the industrial qualities, and especially if it makes men more prudent, if it leads them to prefer a moderate competence to the excitement of speculative business, and the possibilities of rapid enrichment, with the accompanying possibilities of ruin.

### SUPPLEMENTARY READING.

MARSHALL, Book VI. Chap. xiii.

### QUESTIONS.

1. Point out the chief economic considerations bearing on the effects of a Trades Union Rule (1) to limit the number of apprentices in the trade, (2) to limit the hours of work.

2. Discuss the question whether Trades Unions can raise wages, indicating any of the difficulties in their way.

3. Why should Trades Unions insist that none of their members should take less than a defined minimum of wages in each district?

4. What is meant by Co-operation?

How should you account for the exceptional success which has accompanied its application to shopkeeping?

5. A manufacturer arranges to distribute among his employees  $\frac{1}{2}$  of his profits, after taking 5 per cent. on his capital. Wherein does this system resemble, and wherein does it differ from, co-operation? What would be the chief advantages, and what the chief difficulties, of such a plan?

6. Co-operation has done much for the working classes, but it has not (to any great extent) enabled those who do the work to share the profits, except in so far as there are shareholders or customers of the co-operative concern.

Explain this statement, and, assuming its general truth, discuss the causes to which you should attribute the fact.

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<sup>1</sup> This was written in 1889. Later experience has been more favourable, but not sufficiently so seriously to modify the statements in the text. 1906.



## CHAPTER VIII

### EXCHANGE VALUE.

IN the present Chapter we have to consider the question, "How comes it that a certain quantity of one commodity exchanges for a certain quantity of another commodity (neither more nor less)?"

The problem of value.

To answer this question fully would occupy a large volume; and indeed the considerations that may arise are so many and complex that it is doubtful whether our question has ever been fully answered. We shall confine ourselves to the most fundamental forces which determine exchange value.

And, first, it is to be noticed that people are willing to give things in exchange for others, not merely because they desire those others, but also because they cannot obtain them without labour. The amount and kind of labour acquired for producing a thing is the most general of the ultimate causes that determine exchange value. I want a loaf of bread, a hat, and a diamond ring. I find their prices are a penny, five shillings, and ten pounds; in other words, that their values are as 1 : 60 : 2400. The simplest broad general explanation of the fact is that it costs sixty times as much to produce a hat as to produce a loaf of bread of the required kind; and forty times as much to produce the diamond ring as to produce the hat. Whence

Only things that cannot be reproduced without labour have value.

Cost of production.

comes this difference of cost? In the main, it comes from the quality and quantity of labour involved in producing them. We have seen in earlier Chapters that different kinds of labour can secure very different remunerations. But let us suppose for a moment that all kinds of labour ranked equally, and that in a given time the same number of men, working at the production of the several articles, could produce 2400 loaves, sixty hats, or one diamond ring. This would afford a preliminary explanation of the rates at which they exchange for a common measure (money).

In this illustration we seem to have ignored the part played by capital and land in the production of the articles in question. We must next justify this apparent omission. First, in the case of land: We have seen that rent represents the excess of produce over what is produced on the margin of cultivation. We may suppose that some of the wheat used in making the loaves grew on land on the margin of cultivation, and therefore paid no rent. In this case we see at once that no rent enters into the cost of production. But in the case of other wheat, rent simply enters, in a way that equalises the cost of production, on more and less favourable lands. To the individual farmer rent is of course an item in his cost of production; but we shall see further on that it is the cost of *reproduction*<sup>1</sup> rather than that of production which determines value, and this additional produce must be regarded as raised on the margin of cultivation, since it is the better land that is resorted to first. We see then that rent may be eliminated from the cost of reproduction, and therefore from the forces which determine value. But can we

Rent  
equalises  
cost of pro-  
duction.

<sup>1</sup> The cost of producing more of the article in question.

eliminate *interest*? We must here remind our readers that capital is the product of labour. Now, in our supposition concerning the amount of work needed for producing loaves, hats, and rings, we must evidently include the labour necessary to produce the tools and machinery by which those articles are produced, and we introduced the words "in a given time" in order to avoid the consideration of the fact that more interest might have to be paid in one case than in the other, owing to the longer time that might

elapse before capital got its returns. In reality, we have no more right to ignore this difference than we have to ignore the fact that one kind of labour can secure higher remuneration than another. We shall have to introduce both these considerations before we can formulate even a rough "law of value."

Notice next that the fundamental consideration in an exchange is *not* the question what it *has* cost to produce

either commodity, but what it *would* cost to produce another. A new invention may have

greatly cheapened the production of either. No one will give more for an article produced by the old and expensive process than for an equally good one produced in the cheap way. Again, it sometimes happens that it is impossible to go on producing at the old cost. In this case the exchange value will still be regulated by the new cost. It is useless to tell the owner of them that their production only cost

him the smaller amount. „ If you will have to pay the larger

amount for reproduction, he will be able to get that amount from you. Value is therefore measured by cost of reproduction, but not necessarily by the cost of reproducing a *similar* article. A cracked tea-pot would not exchange at a

rate measured by the cost of reproducing a similar article; but at the cost of reproducing an article of similar utility. Let us now sum up the law of value up to the point that we have as yet reached. We find it can be expressed in the following form :

*The value of any commodity, of which the supply can be increased, tends towards the cost of reproducing a commodity of equal utility, and this cost depends on the quantity and quality of the labour involved in the production, and on the rate of interest, and the time during which capital is locked up in the production.*

Law of  
Value.

We will next examine the nature and limitations of the tendency referred to in this statement of the law of value. It may have already occurred to the reader that when a person wants to purchase a commodity he does not generally wait for such a commodity to be reproduced. This is no doubt the case; and it is not by any means the case that the price set upon them is even approximately measured by the cost of reproducing them. If the articles are of a very destructible sort, as strawberries, we shall see that their price often differs greatly from the cost of reproduction; but even in these cases competition *tends* to drive the price *towards* this point. If, year by year, the remuneration of strawberry-growing were decidedly greater than that of other labour of the same quality and quantity, this particular occupation would attract more people into it. In the same way, if fruiterers received more remuneration for their labour than bakers or grocers (after due allowance for differences in the skill, capital, etc., required in the different trades), fruiterers' shops would multiply, and the competition between them would force

It only  
indicates  
tendencies.

down their earnings. Thus there is a constant tendency for value to approximate to the cost of reproduction in the case of ordinary commodities.

In the note on pages 36, 37 we saw that the value of any commodity depends on the supply of it, and the demand for it; and it might seem that a simpler and more general law could be obtained from the relations of Supply and Demand than from that of Cost of Reproduction. But a little thought will show that a law based on Supply and Demand will help us little in accounting for the exchange value of ordinary commodities. A certain kind of hat exchanges for 5s., but it will not help us much in trying to account for this, to say it is because there are 10,000 such hats in the market, and 10,000 persons willing to give 5s. each for them. Even if the fact were so, we should still have to ask how comes it that 10,000, or about 10,000, hats are in the market, and that there are about the same number of purchasers. One element in any attempt at an explanation of this is that hat-makers probably calculated they could produce 10,000 hats of this particular kind for 5s. each; and that the demand at this price would come pretty nearly up to the supply. We are thus brought back to the cost of production when we attempt to analyse value through supply and demand.

There are, however, some commodities which either cannot be reproduced, or which only can be reproduced at a cost which no one would care to incur. An autograph of a deceased person, or a book of a rare edition, or a work of some old master, will serve as an example of the former class. Some works

Value really depends on Supply and Demand,

but demand generally depends on price; and supply on expected price.

Cases where Value is independent of cost of Production.

of art, such as tapestry, and elaborate carvings which command a high price, but not such a price as would make their reproduction lucrative, may serve as examples of the second class.

In all these cases we can get no further than supply and demand in accounting for their value. Suppose there are in existence just three autographs of Shakespeare, all of which would be equally valued by purchasers. If the three were offered for sale at the same time, and all sold at the same price, the price must be one which would *equalise* supply and demand. If *ten* persons were willing to give £50 for one autograph, the competition between them would push the price up. Six persons might be willing to give £60; four to give £65; three persons to give £68: then £68 is a price which equalises the supply of autographs with the demand for them. Suppose, however, that two of our intending purchasers were willing, if necessary, to give £69 a piece, and one was willing to give £70. It is impossible to determine theoretically what the price will be. The sellers might begin by refusing to sell under £70. At this price they would effect one sale; they might then effect another at £69, and a third at £68. On the other hand, the first two of our purchasers might have guessed that they need not give more than £68, and by holding out have obtained the three autographs at this price. In fact the former hypothesis implied some understanding or combination among the sellers. If they had been trying to undersell one another, none of them could have got £70. When we speak of Price as equalising Demand and Supply, we must not forget that by "Supply" we mean the supply *sold*, and not the supply *on sale*; and that every dealer has to determine whether to hold his stock back rather than dispose of it at the price he can get.

How supply  
and demand  
operate in  
these cases.

Nevertheless it remains true that the fact of a sale taking place is an evidence that *at the price at which the sale takes place* Demand=Supply. The words in italics apply to both "Supply" and "Demand"; but the student must specially notice that the word Demand is almost unmeaning unless it be accompanied by the idea of a price (expressed or understood). In our illustration, the Demand for autographs was represented by ten at the price of £50; by six at the price of £60; by three at the price of £68. Such an assertion as that "the supply of cotton goods is greater than the demand" only becomes intelligible when we introduce the idea of a price. There is scarcely any limit to the demand for cotton goods if the price is sufficiently low; while if the price is raised sufficiently, the demand will vanish altogether.

We will now put together the two distinct ways in which we account for the value of commodities, and consider the use we can make of each.

I. Value=that which equalises Supply and Demand.

II. Value tends towards Cost of Reproduction of an article of equal utility.

In the case of ordinary commodities II. is the more important. It affords a real explanation, not indeed of the actual value, but of the approximate value of ordinary commodities in ordinary circumstances. It must be remembered that the "Cost" is estimated by the remuneration that can be ordinarily obtained (1) for the quality and quantity of labour involved in the reproduction, and (2) for the use of as much capital during as long a period as is required for the production. For the explanation of the differences in the

Law II.  
generally ex-  
plains value  
approx-  
imately.

rates at which different kinds of labour are remunerated, and of the amount of remuneration that can be obtained for the use of capital, the reader must turn back to the chapters on Interest and Wages.

We have said that Law II. affords the best preliminary explanation of the value of ordinary commodities in ordinary circumstances. We must now refer to the chief cases when Law II. fails us either wholly or partly.

Cases where  
Law II.  
useless

A. When the supply of a commodity is strictly limited, Law II. becomes unmeaning, for in this case there is no possibility of reproduction.

B. In some cases reproduction is possible but is practically out of the question, as the price obtainable would fall short of their cost.

C. When there has been a great "over-supply."

By "over-supply" we practically mean that the producers have produced more of the commodity than they would have produced if they had correctly estimated the price that would be obtainable. Some change of fashion often accounts for such an over-supply; or the flourishing condition of a trade has attracted into it more capital and labour than its subsequent condition needs, and yet the capital may be in such a form that it cannot be removed without heavy loss, and the labour may involve skill which it had cost much time and labour to acquire, and which would be almost useless in other industries. The position of affairs then corresponds for a time to that in case B, except that reproduction probably goes on at a loss, and to a gradually diminishing extent.

Cases where  
Law II. is  
nearly use-  
less.

D. When there has been a great "under-supply."



By "under-supply" we mean that the producers have produced less than they would have done if they had correctly estimated the price that would be obtainable. Famine, disease, or other catastrophe, may temporarily raise the price of any commodity far above the cost of reproducing it. For instance, the sudden outbreak of a fever may cause a great demand for quinine. If the chemists could have anticipated this demand, they would have had such a stock of quinine as would have kept its price near that which its cost of production would account for; and if they have easy and rapid access to a supply from other markets, the price will soon return to that point. If the chemists tried to keep up the price, new dealers would come into the market eager to share in the high profits that could be made in the business. Nevertheless, for some time the price will be so far removed from the "cost of reproduction" that although the *tendency* spoken of in Law II. remains, it affords little help in understanding why quinine has so high an exchange value.

When the influence of Law II. is either absent altogether, as in cases A and B, or only slightly and distantly operative, as in cases C and D, we are thrown back on the more general Law I. This law applies also to ordinary commodities in ordinary circumstances, although it affords less help than Law II. in accounting for their value.

### QUESTIONS.

1. "Value depends on Supply and Demand." Does this help us much to understand how it comes to pass that a pair of boots of a particular quality cost about as much as a particular kind of hat? Can you suggest any better way of explaining the approximate equality in the prices?

2. "The demand for cotton shirts is at present less than the supply." Show that this statement has no definite meaning unless the idea of some particular value or price is implied. If you heard the phrase used, what would you suppose it implied? • •

3. Which of the two laws of value can be applied to explain why a given piece of land fetches a particular rent? Could you apply either or both to explain the rent of a house?

4. Analyse as fully as you can the causes which determine the price of strawberries at a given time in a given market.

## CHAPTER IX.

### MONEY.

HITHERTO we have referred to Money simply for purposes of illustration. We are all so accustomed to performing our exchanges by means of money that we are apt to forget that when we sell it is generally in order that we may buy. A bootmaker spends his day making and selling boots; with the proceeds he purchases food, clothing, and fuel for his family, and other comforts or conveniences. When the transaction has been completed it is in effect as if he had bartered boots for meat, bread, coals, etc.

In a first survey, such as we have hitherto been making of economic facts, we might have altogether ignored the instrument by means of which we bring about our ultimate barter. But it has been convenient for the sake of greater clearness to speak sometimes in terms of money. For instance, we have spoken sometimes of "Value" and sometimes of "Price"; taking for granted that the reader will understand that Price signifies Value in terms of Money.

The exchange value of a thing is a rather confusing idea, for it makes no mention of the other thing for which the exchange is made, and therefore, though we were seeking for a Law of Value in terms of things in general, we often found it convenient to talk of prices, that is to say, of value in

terms of money. Nevertheless, the student must firmly grasp the fact that money is a means and not an end, and that all our previous results would be true in a community where money was not used.

Such a community would, however, be at a great disadvantage. In it, our bootmaker would have to find people possessing what he needs, and desiring what he has, or else he must effect a series of barter till he gets round to the articles he desires.

Difficulties  
of barter.

Illustrations of the difficulties of such a system will at once occur to every reader. Our bootmaker wants beef. The first butcher he finds with beef to dispose of has no need of boots. Presently, he finds a man who wants boots, but has no beef. At length by good luck he comes across a man who has what he needs, and needs what he has. Even yet the difficulty has only begun. He wants 2 lbs. of beef-steak, but he is not disposed to give a pair of boots for this. A single boot would be of no use to the butcher, and yet a single boot represents more labour and capital than 2 lbs. of steak. At length, after much bargaining, he takes 5 lbs. of steak for the boots, and sets off to find a baker who will give bread for beef. The whole difficulty then begins again. But even such an illustration as this gives only a faint idea of the impossibility of reconciling a state of barter with a complex civilisation, in which division of labour is carried to any considerable extent. Our bootmaker deals in complete products, but what is the man to do whose whole work consists in performing over and over again some simple process of manufacture? Such a man might, no doubt, be paid wages in kind (say in bread and meat), and he might use some of these in paying his rent, and other expenses.

But, in this case, the bread and meat are a clumsy sort of money. He accepts them in payment for his services, partly because he knows that his landlord will accept them in payment of rent. This is the essential feature of money. Whenever people accept anything in return for their services, simply because they know that other people will give their services (or commodities) in exchange for the same thing, that thing is fulfilling the first function of money, for it is a medium of exchange. In the colony of Virginia people were, at one time, ready to accept tobacco in exchange for commodities and services, because they knew that the storekeepers would accept it in return for the goods they sold. Thus tobacco became the money of the colony. "Money is, that money does," says Mr. Walker. Whatever discharges this function, in any market, must be regarded as money within that market. We shall return at a later time to consider some of the difficulties and ambiguities which beset this definition of money. For the present we pass on to speak of the other functions which money may, and generally does, discharge in a community, besides being a *medium of exchange*.

The second function of money is to be what most writers call a measure of value, but which Mr. Walker more accurately calls a common denominator. In bartering boots for beef there would not only be the difficulty of finding two people each of whom had what the other wanted, and wanted what the other had. There would be a further difficulty in settling on equitable terms of exchange. If, however, both parties were in the habit of measuring the value of the articles they deal in, in terms of some other commodity, this second difficulty would

Money as  
medium of  
exchange.

Money as  
common de-  
nominator.

disappear. If a pair of boots is worth 5s., and a lb. of steak were worth 1s., the problem would become of the simplest. If no such common measure were used, every commodity would have to be expressed in terms of every other; but this would be practically impossible. You can express the *prices* of 100 articles by 100 statements; but it would take nearly 9900 statements to express the *value* of each commodity in terms of each of the other 99.<sup>1</sup>

A third function that money often discharges is that of being a *store of value*. If a man owns oxen and wants to make a provision for his old age he will not keep the oxen; for they would "eat their heads off" and gradually die. He might sell them and hoard the money. It is doubtful however if this should be included as a function of money, since he might equally well hoard jewels or other commodities which do not fulfil the essential money function.

Money as  
a store of  
value.

A fourth and more important function is to serve as a *standard of deferred payments*. A great deal of the world's business is carried on with borrowed wealth. The wealth borrowed might be in the form of goods; but to repay in the same form would involve serious inconveniences, and especially the risk that the goods in question had during the interval greatly altered in value. In the case of all debts there is this speculative element, but it is desirable to reduce this to a minimum by taking as a standard of payment some commodity which does not greatly fluctuate in value as compared with things

Money as  
standard of  
deferred  
payment.

<sup>1</sup> This includes beef in terms of bread as well as bread in terms of beef; but even if you dispense with such converse statements, the number it required would be 4950.

in general. There is no necessity of taking *money* as the standard of deferred payments. In practice, however, it is so taken in almost all cases.

We pass on to consider what are the qualities that should characterise the commodity we adopt as money. Here two

Qualities desirable in Money. courses are open to us. We might simply ask what will be the best "medium of exchange," and leave for subsequent consideration whether

this commodity will serve as a good common denominator, store of value, and standard of deferred payments; or we might start with the fact that it is convenient to use one commodity for these four distinct purposes, and therefore seek one possessing the qualities suitable for fulfilling each. We shall mainly adopt the latter course, bearing in mind, however, that the first of the four is the essential money function. The *first* quality therefore needed is General

(1) General Acceptability. Acceptability. Money cannot discharge its prime function unless everybody, or almost everybody, is willing to accept it. This general acceptability can, however, be secured to a great extent by means of a law, making any kind of commodity legal tender, i.e. requiring all who are subject to the law to accept it as a full and final discharge of obligations. If however the Government chooses an unsuitable commodity, the law will be evaded and barter will be resorted to. We shall see in the following paragraphs wherein suitability for our purpose consists.

The second quality which it is desirable that money should possess is Durability, and that *without deterioration*. Cat-

(2) Durability. and wheat are used as money by some savage tribes, but both of these lack this quality. Gold and jewels possess it in a high degree.

The third of the desirable qualities is Portability. Cattle are good in this respect as they carry themselves. Wheat is bad, as its value compared to its bulk is low. <sup>(4)</sup> Portability. Gold is good; but, from this point of view, diamonds would be still better.

The fourth and fifth of the desirable qualities are *Divisibility* and *Uniformity*. Under the latter we may include that the quality is easily defined. Hitherto jewels have seemed even more suitable than gold, but they do not fulfil these requirements. Their value is not easily tested or attested; and to divide them is difficult, and destructive of their value. Metals, on the other hand, are easily coined in any degree of purity. The stamp, edges, etc., serve to prevent wilful mutilation, and as gold and silver possess also the qualities of durability and portability in a high degree, they have, very largely, been adopted as money.

(4) and (5) Divisibility and Uniformity.

There is, however, a *sixth* quality very desirable in money, which gold and silver do not possess to anything like the extent that could be wished. This quality may be described as *steadiness of value*. We have seen

(6) Steadiness of Value.

that money is generally used as a standard of deferred payments. Now, if the delays in payment were always brief, gold and silver would admirably fulfil this purpose. A hundredweight of gold will exchange to-day for about the same quantity of most other commodities as it would have done six months ago. But if the interval is a long one the fluctuations in the exchange value of gold are very serious, and we shall see hereafter that such fluctuations are a great evil. It would not be possible, however, to find any commodity not liable to fluctuations in value, and the best standard for deferred payments would unquestionably be a complex unit



fixed by law, and representing the joint value of the more important commodities. Thus the unit might be the value of a ton of coal + a quarter of wheat + a hundred-weight of iron + a bale of cotton + etc. Suppose this unit at present prices is worth £10, then a person borrowing £500 would have to repay the value of 50 units at the time of repayment. If prices in general had risen in the interval, the sum repaid, exclusive of interest, might be £600; but this would approximately represent what had been borrowed in terms of things in general.

Complex  
Standard for  
deferred  
Payment.

### SUPPLEMENTARY READING.

WALKER, *Money, Trade, and Industry*, Chaps. i., ii., iii.  
MILL, Book III. Chap. vii.

### QUESTIONS.

1. What is meant by Money? Should you include bank-notes and cheques?

*The second part of this question will be discussed in a later chapter; but the student may attempt to answer it here.*

2. Why should the commodity selected for money possess the several qualities enumerated above? What would be the advantages and disadvantages of slaves as money in a primitive society?

3. How far does Paper possess the qualities desirable for money?

*Notice that under durability and divisibility the essential thing is that there should be no loss of value.*

4. What would be the disadvantages and what the advantages of a complex standard of deferred payment?

*Consider the case where the delay in payment is (a) short, (b) long. Notice difficulties of calculation.*

5. Discuss the proposal of having different commodities to discharge the different functions usually discharged by money.

## CHAPTER X.

### METALLIC MONEY.



#### SECTION A.

##### THE ENGLISH METALLIC SYSTEM.

MANY different commodities have been used for money, but in civilised countries the alternative has practically been between metals and paper. In England, at the present day, we use several kinds of metal as well as paper money. But *gold* is the basis of our currency. The value of our silver and bronze coins is settled *by law* in terms of gold. The reason why 20s. exchange for a sovereign is simply that the Legislature has enacted that shillings shall be accepted at this rate, up to a certain amount. If we melted down our shillings and our sovereigns, it would be found that the gold in a sovereign exchanged for considerably more than the silver in 20s. But we compel people to accept 20s. as equivalent to a sovereign; and they are perfectly willing to do so, because they know that other people are bound to accept them at the same rate. If the Government chose to coin shillings containing only half the present amount of silver, these shillings would exchange for the same amount of tea, bread, etc., as the present shillings. The Government could make an additional profit in this way, but it would increase the temptation to coiners.

The English system of money has gold for basis.

it would be impossible for any private person to coin shillings of the same quality and appearance as those issued from the Mint, without incurring a loss. The expense of the coining would more than swallow up the difference between the value of the silver and the coin, unless the coiner could get an immense stock of the false coins into circulation. But if the amount of silver in our coins were halved, the issue of false coins scarcely distinguishable from the real would be much facilitated. Even under the present system, the Government makes some profit, as an ounce of silver, worth little more than 2s., is coined into 5s. 6d.

The bronze coinage is based on similar principles, but the difference in value between the coins and the metal in them is proportionately greater. There is only about a farthing's worth of metal in a penny, and the reason why it exchanges at the rate of 240 pennies for a sovereign is that the Government compels all its subjects to accept pennies at this rate up to one shilling. We express the fact by saying that pennies are *legal tender* up to one shilling. Halfpence and farthings are legal tender up to 6d. Silver coins are legal tender up

to £2. Our subsidiary coinage (silver and bronze) has a value determined by law in relation to sovereigns. But how is the value of a sovereign determined? It is not determined at all. The sovereign simply exchanges for what it will fetch. It is a piece of gold, the quality and quantity of which is attested by the Government, as being between certain limits. It then exchanges for what it will fetch. But for the Government attestation it might be regarded as differing in no essential from any other bit of gold of equal size and purity. The exchange value of a sovereign is equal to the exchange

Sovereigns  
exchange ac-  
cording to the  
value of gold  
in them.

value of the gold it contains. If the coin were worth appreciably more, people who have gold for sale would make a profit by bringing it to the Mint, since the Government is always willing to coin gold at its own expense. So too if the coin were worth less than the gold it contains, it would be profitable to melt it down and turn it into bullion. The gold coins simply exchange as gold, in a convenient form. Gold is legal tender up to any amount. People accept it for services and commodities because they know that other people will do so; but no external authority decides how much coal, iron, or cotton shall be given for a sovereign, or, what comes to the same thing, how much gold shall be given for a ton of coal or iron, or for a bale of cotton. The exchange value of gold will depend on the same laws as the exchange value of other things, the laws which we arrived at in Chapter VIII.

We have seen that value is a relative term. If the gold in a sovereign is worth two tons of coal, this is only another way of saying that a ton of coal is worth half-a-sovereign. By the price of a thing we mean its value in money; so that when we say that the price of coal is rising, we mean just the same as when we declare that the value of gold, as compared with coal, is falling. If we want to account for the fact, we must examine into the demand, the supply, the cost of production not only of coal, but also of gold. The rise in the price of coal may be due to an increased demand for coal, or to a diminished demand for gold; to a diminished supply of coal, or to an increased supply of gold; to an increase in the cost of producing coal, or to a diminution in the cost of producing gold. We shall, however, for the present, limit ourselves to causes affecting the demand and supply of gold,

and the cost of producing it. What we say of gold will, of course, equally apply to silver in countries where silver is the basis of the currency.

In examining the causes of the exchange value of gold, or, in other words, of the prices of other commodities, so far as that value depends on facts directly affecting gold, we have first to ask which of the two laws of value we shall use. Does the value of gold approximately amount to the cost of reproduction, or must we simply seek to explain it by the law of supply and demand? (See pp. 90 to 92.) I apprehend that, in the long-run, the exchange value of gold must tend to approximate to the cost of producing it, measuring this cost by the quality and quantity of the labour necessary for its production, and the quantity of capital and length of time which the production involves. For gold-mining is pursued like other trades. If it is expected to be more remunerative than others which require equivalent labour and capital, these will flow into it, till the expected remuneration and profits of the work are reduced to the level, or below the level, of those in what are otherwise equally attractive occupations. Thus the supply of gold will tend to adapt itself to the expected demand for it at a price which equals the cost of production. But the tendency will

Why the value of gold is far from equal to cost of reproduction.

in this case be of a kind which operates in a certain direction, but is far from bringing about at any given time an approximation to that whereunto it tends. For gold is a commodity so durable in character that the supply of gold in civilised lands is only slightly affected by the additions made to it in any year. The addition made to it may be considerable, but it is likely to be only a very small frac-

tion of the whole stock. Now the tendency of value to be nearly equal to the Cost of Reproduction, rests on the assumption that Supply can be easily brought up to Demand at a remunerative price; and where the supply, as here, mainly depends at any given time, not on what has been produced during the past year, but on what existed when the year began, we cannot regard cost of production as exercising more than a slight tendency towards equalising supply and demand, or in other words towards determining value. Besides this we must notice that gold-mining is a business of a very speculative character, and that those who enter into it seldom possess trustworthy data on which to estimate the remuneration they will receive. The production of gold is only slightly affected by changes in its exchange value, and on this account, too, the law of the Cost of Production is of very little help in explaining the value of gold in terms of other commodities. In the main, therefore, we are driven to account for the exchange value of gold by the law of Supply and Demand.

*The Supply of Gold as Money* is of course the total gold coinage minus so much of it as is hoarded, or held in reserve.

Supply of  
and Demand  
for Gold.

*The Demand as Money* depends mainly on four different considerations: (1) on the quantity of goods sold for gold. If more goods are sold, more gold is needed to effect the sales, other things being the same. (2) On the rapidity with which the gold coins circulate. Ten purchases at £1, made in the same day, may all be made with the same sovereign, or they may require ten sovereigns, or any intermediate number. (3) On the extent to which notes, cheques, and other forms of credit take the place of gold payments.

In England, for instance, most large payments are made by cheque, and do not require gold. (4) On the extent to which coins of other metal are used. These again depend on many complicated considerations. If for instance we wanted to investigate the causes of the supply of gold money in England, we should have to account first for the supply of gold in the possession of the various nations, who form that group of which for industrial purposes England is a member; and secondly we should have to consider what determines the territorial distribution of this stock; how it is divided among the different members of this group of nations. All these questions will be partly considered in later sections of this book.

### SECTION B.

#### GOLD AND SILVER SUPPLY IN EUROPE.

Fluctuations in general prices have played so important a part in the social history of nations that we will here review rapidly the history of the gold and silver supply of Europe during the past 1800 years, and its relation to general prices.

**Great decline of supply from A.D. 14 to A.D. 806.** It is calculated that in A.D. 14 the total stock of gold and silver in Europe was worth about £358,000,000, but that this was steadily diminishing during the next eight centuries, so that by A.D. 806 the stock was only £34,000,000. As we should have expected, the exchange value of the precious metals was steadily rising during this time, or, in other words, general prices were falling.

From 806 to 1520 the supply seems to have been pretty stationary, but prices continued to fall. We must therefore assume that the demand for gold and silver money was

growing. The growth was no doubt due to the increase in population and trade, an increase that was no doubt very slow, but yet sufficient to make a considerable difference in the course of six centuries. America was discovered in A.D. 1492, but some time elapsed before the American mines began to yield their produce to Europe. Prices reached their lowest point about the year 1520. They were then, in the case of the common necessities of life, not more than one-twelfth of what they are at the present time.

Supply  
stationary  
while de-  
mand in-  
creased,  
806-1520.

From 1520 the supply of the precious metals increased very rapidly. It is calculated that in the forty-four years from 1545 to 1599, more silver came to Europe from the mines of Mexico and Peru than three times what had been the whole European stock in the year 1500. Nevertheless, so far as England was concerned, there was little rise in general prices till about 1570. This is probably to be accounted for by the fact that most of the silver went to Spain in the first instance, and that there was a great increase in the demand. From 1570 to 1640 prices rose in England to about three times what they were in 1570, though the increase in trade and population must have greatly increased the demand for money. After this the rise in prices was only gradual and intermittent, though the supply of silver was steadily increasing. From about A.D. 1810 prices began to fall. This is partly accounted for by the interruption of silver-mining in what had been the American colonies of Spain. These had now declared their independence, and were in a very disorderly condition; but other causes co-operated in England, especially after 1815. We shall speak of these causes in a later chapter.

Silver pours  
in from  
America  
from 1520.



The gold discoveries in California (A.D. 1848) and in Australia (1851, etc.) completely changed the situation. The value of gold sank rapidly both in relation to silver and to almost all kinds of commodities. In other words, general prices, measured in gold, rose rapidly till about 1873. For the next twenty-three years the movement was the other way. There was a great demand for gold, especially for the coinage of Germany, Italy, and the United States, and as a natural consequence prices have been falling.

Effects of  
gold dis-  
coveries,  
1848 to 1874.

Recent fall  
in prices.

## SECTION C.

### FLUCTUATIONS IN PRICES.<sup>1</sup>

The brief review given above will serve as an introduction to the question whether a rise in general prices is a good or bad thing for the community; or whether (as some hold) it is not of much importance either way.

Are high or  
low prices  
desirable?

The argument by which this last view is defended may be summarised thus:—

Argument  
for their  
being a  
matter of in-  
difference.

“Prices only represent the value of commodities relatively to money. But it is commodities and not money the community needs. If the money in every one’s possession were doubled, the prices of all things would of course rise, but this would not involve any increase in the stock of those necessities, comforts, and

<sup>1</sup> Fluctuations in prices are generally due to other causes than the supply of the precious metals, especially to paper money and other forms of credit, but it is convenient to introduce some remarks on this subject at the present point.

luxuries which money brings. An increase in prices, at least if it is due to an increase in the stock of money, leaves the world exactly where it found it in respect of those things which satisfy human desires; except indeed that it may gratify the purely miserly desires of those who regard money as an end and not a means."

This argument embodies a very important truth. Familiarity with it might save people from exaggerating the importance of a general rise or fall in prices. Nevertheless the argument omits to notice one important fact, which partly modifies the conclusion based upon it. This fact is that even when the change of prices leaves the stock of commodities (other than money) what it was, it alters the distribution of that stock in favour of either debtors or creditors. We have already noticed that a large proportion of modern business is done with borrowed capital; but even apart from this there is a great load of indebtedness growing out of former loans. All holders of shares, dividends, consols, etc., are in the position of creditors, and for each of these there must of course be a corresponding debtor. Anything, therefore, which affects creditors or debtors favourably or unfavourably is very important to the community, even though the gain of one is exactly balanced by the loss of another. Now a change of prices has such an effect. While the debt and the interest due on it are nominally unaltered, their purchasing power has become something different from what it was when the arrangement was made. If prices have risen by twenty per cent. it is little satisfaction to the creditor that he is receiving the amount in money that was promised him, for he can now only purchase ten things with that which when the loan was made would purchase twelve. Every rise

in prices benefits debtors at the expense of creditors; and conversely every fall in prices benefits creditors at the expense of debtors. A man's real income depends not on its nominal amount, but on the amount of commodities and services he can secure by it.

We see then that a change in prices alters the distribution of wealth; but it has next to be noticed that the producing classes are mainly in the position of debtors, and the non-producing classes mainly in the position of creditors. This is very clear when a producer has borrowed from a non-producer; *i.e.* in the large number of cases where business is carried on with borrowed capital. In a Joint Stock Company the shareholders are creditors, with a claim on the produce. If this claim involves the right to a fixed annual payment (as in the case of preference shares), it is clear that the shareholder suffers from a rise in prices, and gains from a fall. His debtors are, in effect, those who produce the wealth out of which the claim is paid. If prices fall, the fixed payment becomes in effect a heavier burden on the business. It matters comparatively little which of the producers takes the risk in the first instance. It may be only another body of shareholders. But every burden on the business makes it more difficult to carry on or to enlarge; and the workers suffer from consequent contraction. Or take the case of the National Debt. A man living on the interest paid on this is, as such, a non-producer. His real debtors must be of the producing classes, since the interest must somehow be paid out of the produce of labour.

We see then that a rise in prices is, other things being the same, a benefit to the producers and an injury to non-

producers except where the amount which the non-producer draws is not a fixed amount, but liable to being immediately adapted to the change in prices. Rent, for instance, so far as fixed by competition, would adapt themselves to a change in prices if that change were simply due to an increase in the supply of money. But even in such cases we have to remember the effects of *inertia* in delaying adaptation. Shareholders whose receipts are in no way fixed, whose dividends depend wholly on the success of the business, must for the purposes of this argument be ranked as producers: their share in production may be considered to consist in taking the risk. Conversely, and with similar qualifications, it may be said that a fall in prices due to a diminished supply or increased demand for money is a benefit to non-producers, as such, at the expense of producers.

This brings us to another fallacy involved in the argument of those who maintain that such changes of price are a matter of comparative indifference.

The whole argument (see page 108) rested on the assumption that the supply of ordinary commodities was unaltered.

But in reality a rise in prices will act as a stimulus to production, and that for two reasons. We have seen that such a rise lightens the burden on the producers; but apart from this just ground for increased hopefulness, it is certain that a rise of prices gives an encouragement to production, which is not the less real because based on a delusion. A man in business is both a buyer and a seller, but so far as his business goes his sales bring more money than his purchases take away, otherwise he would soon fail. A rise in prices spread equally over all commodities results therefore in leaving him a larger balance.

But the same man is also a consumer. He spends some or all of the balance for other than business purposes, and it is no gain to him that the balance is greater in money unless it goes further in the purchase of commodities and services. Nevertheless experience shows that even in this case such a man is encouraged by a rise in prices. Accustomed to estimate his profits in money, he is apt to pay comparatively little attention to the prices of the things he consumes as a private individual; and therefore he derives encouragement even from a rise in prices, which, but for this artificial encouragement, would have left him as he was.

On the whole, we conclude that a rise in prices, due to changes in the supply and demand for money, encourages production, and that, conversely, a fall in such prices discourages production and depresses industry.

It might therefore seem that a rise of prices, and even a rapid rise, is a very desirable thing. But this does not follow. In the first place, we must not disregard the "non-producers." Many of those who do not "produce" in the economic sense are doing good and useful work; some of those who live on fixed incomes are eminently deserving of consideration, and are among the chief sufferers from a rise. Secondly, it should be noticed that the encouragement given to production by any considerable rise in prices is often excessive and leads to a reaction. We shall have at a later time to refer to the effects of speculation on the alternations of good times and bad. At present it is sufficient to remark that all rapid changes in prices introduce an element of gambling into industry, and tend to a certain amount of demoralisation. Lastly, it is to be noticed that through the *inertia* of trade the wage-earning

Disadvantages of rise in prices.

classes often fail to secure an advance in wages proportional to the rise in prices. Trades Unions have done much to remedy this, but even in trades where Unions exist, custom counts for much in wages. On the whole, it may be said with some confidence that changes in general prices are undesirable, whether the movement be upwards or downwards; and it seems most consonant with general principles of equity that debts incurred should not fluctuate in their real value in consequence of fluctuations in prices.

Fluctuations  
in prices  
generally  
undesirable.

## SECTION D.

### BIMETALLISM.

We have seen that in England gold is the basis of the currency. In some countries silver has been adopted for this purpose; in others both metals have been made legal tender by law, that is to say, it has been ordained that either metal may be tendered to any amount in payment of debts. This last system is known as Bimetallism. The English reader will best realise its meaning by supposing that our Government determined to coin shillings, each of which contained one shilling's worth of silver, and ordered that these shillings should be (equally with sovereigns) a legal discharge of any obligation to pay. Under such a system gold and silver coins would circulate simultaneously, so long as the relative exchange value of the two metals was not altered. But let us next suppose that owing to a large yield of silver from some mines, the value of silver relatively to gold, diminished, so that the gold in a sovereign came to be worth

Bimetallism.

All payments  
will be made  
in whichever  
metal is de-  
preciated.

twenty-one of our new shillings. Every one would now find it paid him best to make all payments in silver. The possessor of a sovereign might melt the coin down and sell the metal for twenty-one shillings. He could pay twenty of these in lieu of the sovereign, and make a profit of a shilling by the transaction. Accordingly, all payments would be made in silver, and the gold coinage would disappear. If, on the other hand, it was gold which was depreciated, the silver coins would pass out of circulation. They would be melted down or exported, and no one would bring silver to be coined, since its value as bullion would be greater than its value as coin.

History affords many illustrations of the difficulty of keeping two metals circulating simultaneously at their real value. From A.D. 1717 to A.D. 1769 no silver was coined in England, though our currency was then, in theory, bimetallic. The gold in a guinea had come to be worth somewhat less than the silver in twenty-one shillings. Accordingly the possessors of silver found it paid them best to keep it as bullion. From A.D. 1794 to A.D. 1834 in the United States no gold was coined. For the coinage was based on the assumption that gold was fifteen times as valuable as silver. In 1834 the Legislature resolved to alter the coinage on the assumption that the true proportion was as sixteen to one. Then silver ceased to be coined. Silver was, in reality, more than one sixteenth and less than one fifteenth of the value of gold, and this practical difference was sufficient to make the coinage practically monometallic though in theory bimetallicism existed. These instances are sufficient to show the kind of difficulty which besets any attempt to keep two metals circulating at their intrinsic value. The value of each depends on the supply and demand. The supply of each depends largely on the

chances of mining and mine discovery. The demand for either may be affected by a mere change of fashion. How can you expect the relative value of the two metals to remain constant? And yet any noticeable change in this relative value suffices to drive out of circulation whichever metal is appreciated.

The Bimetallists reply, "No doubt any appreciable change in the value of silver as compared with gold will drive the appreciated metal out of circulation. But there are forces at work under a bimetallic system which may hinder and even prevent changes that would otherwise take place in the relative value of the two metals. Let us suppose that the United States Government in 1834, instead of coining on the assumption that gold was sixteen times as valuable as silver had calculated the existing relation more accurately, and had found it to be  $15\frac{1}{2} : 1$ . So long as this remained the proportion, the two metals would have circulated concurrently. Presently, perhaps, something would have occurred tending to appreciate gold, *i.e.* to increase its exchange value. This might have led to the exporting or melting down of *some* of the gold in circulation; but that very conversion of coin into bullion would increase the supply of gold in the market for purposes of ornament, etc. At the same time the increased demand for silver coins (to take the place of the gold ones that had been driven out of circulation) would tend to appreciate silver. Both forces are counteracting the original tendency towards an appreciation of gold, and unless the forces producing such an appreciation are very strong and lasting, the balance will be restored before all the gold is driven out of circulation. Failing this, the Government must alter the coinage, adapting it to the new exchange value of

Bimetallism  
would tend  
to steady  
relative value  
of gold and  
silver.



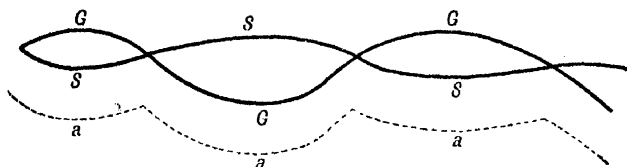
the two metals, but such alterations will not be necessary except at rare intervals, and in the presence of disturbing forces of quite unusual strength."

This argument is of undoubted force; in fact the only questionable point in it is the assertion that what we may call the restorative forces would be sufficient to restore the old proportion after a certain amount of the appreciated metal had been withdrawn from the currency. Even in reference to this, it has to be noticed that for two centuries (A.D. 1657 to A.D. 1857) the relative value of the two precious metals only altered very slightly. It never rose above 16:1, nor sank below 15:1. This remarkable stability in the face of considerable variations in the supply of both metals is probably to be accounted for by the existence of bimetallism in many countries during those two centuries. It may be contrasted with the great variations in the ratio since bimetallism has been practically almost abandoned by the various commercial nations. The great gold discoveries in Australia and California were among those exceptionally violent disturbing forces, in the presence of which (as bimetallists admit) the legal rates must be changed; but the experiences of the preceding two centuries certainly seem to confirm the theory that a bimetallic system supplies forces which do much to steady the relative value of gold and silver; and it is not unreasonable to suppose that if the system were generally adopted by the great commercial nations, the proportion might be kept unchanged, not only for years, but even for centuries.<sup>1</sup>

<sup>1</sup> The larger the number of bimetallic nations, the larger, of course, would be the stock of gold and silver coins from which to draw when either tends to be appreciated. The fluctuations referred to above were largely due to the conflict of national ratios, which would disappear under an international system.

But bimetallists further maintain that even if the system broke down to the extent of altogether driving sometimes one metal and sometimes the other out of circulation, its influence in steadying prices would compensate for the inconveniences of such alternations. We have seen that money serves as a standard of deferred payment, and that therefore it should be of such a nature as not to fluctuate greatly in value relatively to things in general. Neither gold nor silver fulfils this function well except for short periods. But a currency with both metals as legal tender would fluctuate less in exchange value than one confined to either. The following diagram will serve to show this:—

Bimetallism  
not useless  
even if only  
one metal  
circulates at  
a time.



Let the line G G G represent the fluctuations of gold as compared with things in general, and the line S S S represent the simultaneous fluctuations of silver. Then the lower (dotted) line a a a will represent the fluctuations of the currency under a bimetallic system. For we have seen that the appreciated metal will be driven out of circulation, and the actual fluctuations of the currency will therefore be represented by the lower line. Now the fluctuations of this must always be less than those of one, and will generally be less than those of either, of the original lines. The result will be similar if both metals are kept in circulation by the restorative forces referred to above, for the supply and demand of the

two metals jointly is likely to be steadier than that of either singly. It is improbable, for instance, that great discoveries of gold-mines will be contemporaneous with great discoveries of silver-mines, and the new supply resulting from discoveries will bear a smaller proportion to the existing supply of the precious metals than to the existing supply of either taken singly.

On the whole, therefore, the arguments in favour of bimetallism seem to me very weighty. If, however, we were limited to one metal for our basis, gold would certainly be preferable to silver in such a country as England; and we must not forget that if we adopted bimetallism we should at least be liable to having for considerable periods what would practically be a silver currency, unless we were prepared to alter our legal proportion whenever such a thing took place. When we come to speak of inconvertible paper money we shall see the great danger of tampering with the currency, and frequent alterations in the legal proportion between the value of the two metals would involve some of these dangers.

Gold preferable to silver for basis.

#### FOR SUPPLEMENTARY READING.

WALKER, Chaps. iv. to vii.

MILL, Book iii., Chaps. viii. and ix.

#### QUESTIONS.

1. What do you consider the chief qualifications that have to be made in the statement that prices depend on the productiveness of mines?

2. What would be the effect on prices if the stock of money were suddenly doubled, other things remaining the same?

3. Explain clearly what is meant by the demand for money.

4. How are prices affected by the fact that gold and silver are of so durable a character?

5. Suppose gold mines discovered in a country without foreign trade. Consider the probable effects on the following classes of the community.

(i.) Persons with fixed incomes from invested capital.

(ii.) Salaried officials.

(iii.) The wage-earning classes.

(iv.) Employers of labour.

Consider whether each class is in position of debtor or creditor. Notice the effect of custom and vested interests on salaries and on wages.

6. Prices were very low in England in the fifteenth century, and rose rapidly from 1510 to 1640. How far should you connect these facts with the prosperity of the agricultural poor in the former, and their distress in the latter?

*Distinguish between HIGH prices and RISING prices. In the fifteenth century, prices were pretty stationary, and social conditions made the question of high and low prices of subsidiary importance. Consider why this was so, also causes of sixteenth-century distress, other than rising prices.*

7. What objections would there be to an Act of Parliament ordering that shillings should henceforth rank as half-crowns?

Consider (i.) immediate effects, (ii.) effect in encouraging false coinage, (iii.) general objections to tampering with coinage.

8. How should you define a sovereign?

*Quality, quantity, Government Stamp.*

9. What is meant by the appreciation of gold? Account for the appreciation in the period 1873 to 1896.

*The yield of gold mines has been diminishing, and that of silver mines increasing since 1852. Germany adopted gold in lieu of silver, as the basis of its currency 1871-3. Norway, Sweden, and Denmark followed. The United States, Italy, France, and Greece have since then practically adopted gold instead of what was practically a paper currency; Belgium and Switzerland instead of what was practically bi-metallic.*

NOTE.—One chief object of Bimetallists is to get rid of "Exchange" fluctuations consequent on the different bases of the currency in different countries. This cannot be properly discussed at this stage of our work. It is right to add that the fluctuations referred to on page 114 were largely due to the existence of different legal ratios at different mints.

## CHAPTER XI.

### PAPER MONEY.

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#### SECTION A.

##### INCONVERTIBLE PAPER MONEY.

WE call Paper Money *convertible* when some way is provided for enabling the holders to exchange it for gold, or some other commodity of intrinsic value, other than the spontaneous willingness of individuals to give such commodities in exchange for it.

Convertible  
and Inconvertible  
Paper.

Thus the holder of a £5 note, issued by any English Bank, who presents it at that Bank during business hours has a right to claim £5 in gold in exchange for it. But many Governments have at different times authorised the circulation of Paper Money which is not convertible, and it will be convenient for us to begin by examining the theory of such

inconvertible Paper Money. Experience has clearly shown the possibility of keeping such paper in circulation, especially if the Government enacts that it shall be received as a legal discharge of debts and other obligations. People will accept in payment what they know other people will accept, and even if there is no expectation of the paper ever being convertible it may pass freely from hand to hand. Inconvertible

Expectation  
of converti-  
bility not  
essential for  
circulation.

paper money has even some distinct advantages over gold and silver. In the first place, the Government may derive great pecuniary advantages from its use. It can purchase, for a few shillings, paper which it can issue as notes for a million of pounds, and almost the whole of this million becomes profit. This is so much saved to the tax-payers, and the question naturally arises why a Government should not altogether dispense with taxes and pay for all it wants (including the paper for its notes, and the machines and labour required for stamping them) in the paper it thus issues. Before attempting to answer this question, we will briefly indicate some of the other advantages of paper as money over gold or silver. In the case of the latter there must necessarily be some loss and inconvenience from the abrasion caused by use. In the case of paper, this practically disappears. A soiled note will pass as well as a clean one, and even if it has to be replaced the loss is inconsiderable. Thirdly, it may be noticed that paper money might conceivably be the very best standard of deferred payments. We say *conceivably*, because as a matter of fact, and historically, it has often been about the worst possible for this purpose; in some cases it has been so bad that the trade and manufactures of a country have been almost annihilated by the objectionable character of the currency. Of this we will presently give illustrations; but we had better begin by explaining in a theoretic way the fundamental characteristics of an *inconvertible paper currency*.

We will suppose a Government issues some *inconvertible* paper at a time when there are no special circumstances

*Inconvertible currency (1) gives immediate profit.*

*(2) Saves loss from abrasion.*

*(3) As standard of deferred payments.*

affecting the demand for money, or tending to attract gold to or from the country. It follows that the exchange value

Operation of issues of Inconvertible Paper. of money will fall, since the supply has been increased while the demand is stationary. In other words, the price of all commodities *including*

gold will rise. In other words, for £5 of money, whether in gold or notes, you can no longer purchase as much gold as there is in five sovereigns, and it would pay to melt sovereigns

Gold driven out of currency. down and sell the bullion. The Government could, of course, prohibit such melting, but such

a prohibition would be hard to enforce; if this difficulty were overcome, the result would only be equally secured in another way. For the gold would be sent abroad. To explain this, let us take some commodity which is partly produced at home and partly imported (say, wheat). It is evident that both kinds of wheat will normally fetch the same prices for equal qualities. The price of wheat would clearly tend to go up from the increased supply of money; but it is still worth the foreigner's while to bring us wheat for the old amount in gold. If he asks for more he would probably be undersold by some other foreigners, unless the amount imported increased. Consequently more foreign wheat will come in, and less wheat will be produced in England. But the importation of wheat will naturally involve the exportation of gold in payment for it. No doubt it may conceivably happen that the competition among foreigners to supply the English wheat market may not be sufficiently severe to prevent the natural rise of the price of wheat consequent on the increased supply of money. But there would almost certainly be some commodities of which the importation would be increased by any considerable rise

of prices, and thus we are brought back to the conclusion that an issue of inconvertible paper money will tend to drive the precious metals out of circulation. This process of expulsion will go on till prices return to something like their old level. This would be when the amount of money in circulation was as small as it would have been if no paper had been issued; or, in other words, the value of the gold expelled would be about equal to the normal value of the paper issued. Suppose now, fresh issues. The same process will recur till all the gold has gone out of circulation.

Up to this point the issue of paper money will probably not have caused any gigantic evils. The fluctuations of price will have been annoying and injurious. Not <sup>Effects of</sup> only will some people have gained at the expense <sup>further issues.</sup> of others; but an element of uncertainty will have been introduced, and persons who might otherwise have been productively employed will have been speculating on the rise and fall of prices. But let us next suppose that the Government persists in issuing paper money after gold has been altogether driven out of circulation. There is now no means of restoring the level of prices, since there is no more gold to disappear. The rise in prices thus becomes a permanent fact, and no one can tell how far it will go. It all depends on the arbitrary deed of the Government; and the more prices rise the stronger will be the temptation to issue fresh paper; for the Government itself has to pay the enhanced prices for all that it needs, including the services of its soldiers, sailors, policemen, and officials of every kind. It probably began to issue under the pressure of financial difficulties; and these difficulties it has now aggravated by its own act. It now finds itself on a dangerous slope, and woe



to it and to its subjects if it slides down the easy road that leads to ruin.

We are now in a position to study some historical cases illustrating the theory of inconvertible paper money. Let us first take the case of Revolutionary France.

We need not enter into the causes of the financial embarrassment of the French Government in 1789. It must suffice to say that it was mainly pecuniary difficulties  
Case of France, 1789, etc. which had driven the King to summon the States-General. The riots that soon followed had made things worse. One of the plans resorted to by the National Assembly was a partial disendowment of the Church. The Government took over the Church lands, but promised to pay salaries to the clergy. If the lands had been put up to sale at once they would have fetched low prices; so the Government resolved to issue paper money to the amount of 400 millions of francs. The notes, or assignats, as they were called, were to be convertible into land. The assigning the notes to this purpose probably helped them into circulation; for it was generally known that many Frenchmen earnestly desired to purchase land, and would, therefore, gladly accept the assignats; but the main reason why the value of this fresh issue was kept up was because it was not sufficiently large to drive all the precious metals out of circulation. But in 1790 and 1791 there were fresh issues, the latter of which was in direct violation of a pledge which the Government had given. From this time the currency was utterly disorganised. The precious metals disappeared from the currency. It was necessary to issue notes to take the place of silver coins. These were extensively forged. Prices rushed up, not merely because so much paper had been issued, but also because no one knew

how much more might soon be thrown on to the market. Capital flowed away from the country. Most trades became mere gambling. The Government in desperation multiplied its notes, and prices rose to such a height that we read of 400 francs being paid for articles which had formerly sold for half a franc. Whenever possible, people resorted to barter. Small farmers just produced what they and their household wanted and almost gave up buying and selling. It was not merely that the nation, as a nation, became bankrupt. Individuals were reduced by thousands to abject misery, and the world was given most conspicuous example of the perils that may arise from tampering with the currency, and of the difficulty of pausing after advancing some way in a policy of issuing inconvertible paper money.

It must not, however, be supposed that anything like this great catastrophe is necessarily involved in any resort to inconvertible paper. Our next illustration will show the effects of a far more cautious adoption of the same policy.

In 1796 England had been for three years engaged in a great war with France. The fear of an invasion had just caused a run on many country banks. These had withdrawn their reserves from the Bank of England, and in 1797 the specie reserve in that institution had sunk to about a million pounds. The Government then intervened, and an Act of Parliament was speedily passed which forbade the Bank from paying in specie except in certain specified cases. This of course made the Bank of England notes inconvertible. But the firmness and prudence of those at whose discretion these notes could be issued kept the paper up to its full nominal value in gold for eleven years (1797-1808). Then a depreciation

Case of  
England,  
1797, etc.

began, and by the year 1814 the price of gold (in notes) had increased from £3, 17s. 10½d. to £5, 4s. per oz. The close of the war led at once to a fall in the premium on gold; in fact the premium began to fall as soon as a speedy termination of the war became pretty certain. This illustrates the fact that an issue of paper may cause an aggravation of prices, not merely by increasing the stock of money, but also by frightening people with the prospect of future rises in price. The premium on gold is thus artificially increased, and in this case the diminution of suspicion sufficed to bring down the premium. After the Peace the fall in the premium was so rapid that in 1817 the Bank undertook to redeem a portion of their notes at par, viz., all notes for £1 or £2 issued prior to January 1st, 1816. It was found that few people cared to avail themselves of this offer. The holders of small notes were willing to lose the small premium for the sake of the convenience of the notes. The Bank then offered to give the full nominal value for larger notes of the same date; but it soon appeared that in the case of the larger notes the premium was sufficient to more than counterbalance the convenience, and Parliament again intervened to save the Bank from breaking. A Bill was passed fixing the rates at which notes were to be redeemed at successive periods, and requiring that all notes should be convertible at their full nominal value from May 1st, 1823. As a matter of fact the Bank did not avail itself of the full delay allowed by the Act. The gradual fall of the premium on gold after the Peace was naturally accompanied by a general fall of prices, and this was greatly aggravated by the outbreak of revolutions in Spanish America, and the consequent interrupting of silver-mining. There were not wanting people who blamed the

Government and the Bank Directors for an excessive haste in returning to cash payments. Others, on the contrary, maintained that the notes should never have been allowed to become inconvertible; and that even if the drain of gold in 1797, and the need of precious metals for subsidising our allies, partly justified the restriction of cash payments, no time should have been lost when the war was over in putting an end to such restrictions.

It will not be possible here to enter into any full examination of these opposed views. It is quite possible that a more gradual resumption of cash payment would have mitigated the distress that characterised the early years of the Peace; but, on the other hand, it must be remembered that till the paper currency sank to the amount that would exist under perfect convertibility, there was sure to be an element of uncertainty most unfavourable to the confidence that was essential for a permanent revival of trade.

## *SECTION B.*

### CONVERTIBLE PAPER MONEY.

By convertible Paper Money we mean notes for which the Issuer is bound to give coin, on demand, up to the full nominal value of the notes. Such notes are for many purposes convenient. In the case of large sums the mere saving in weight is a consideration. To carry a thousand sovereigns is a serious matter, while the weight of a £1000 note is scarcely appreciable. Then there is the greater security. If you lose five sovereigns, the chance of recovering them is often small; but a £5 note can be stopped, and even if no one finds the note, the

Advantages  
of Convertible  
Notes :  
(1) Weight.

(2) Security.

bank will pay the money if the necessary evidence of ownership is forthcoming. But besides such conveniences there is

a distinct economy arising from the use of paper money, even though that paper is convertible on demand. Experience has proved that the issuer need not keep a stock of gold anything like equivalent to the notes he has circulated. The holders of the notes *might* simultaneously present them for conversion; but this is a most improbable contingency, and the plan under which the English banks all keep their chief gold reserve with the Bank of England further reduces the amount of gold which need be held as a reserve. For the reserve in the Bank of England can supply any bank on which there is an exceptional "run" with gold sufficient to

meet its needs. Of course *some* risk must be run unless the reserve is kept up to the whole amount of the notes in circulation; and it seems clear that a Government is justified in interfering to prevent this risk from becoming excessive through the carelessness or greed of those to whom the right of issuing notes is confided. On this point economists are agreed; but they differ on the question whether the functions of Government in the matter should be limited to providing security against excessive risks of the notes not being actually convertible on demand.

Some economists maintain that so long as convertibility is ensured there can be no over issue of notes, as the smallest depreciation of the currency would lead to the notes being presented. "For who," they ask, "would keep a depreciated note when he can obtain its full nominal value by presenting it at the bank?" No doubt if the notes had been made legal tender there would be less motive for converting them; but even

But this involves risks.

Can there be an over issue apart from such risks?

then, as shown on page 122, we should have a state of things encouraging an importation of commodities and an exportation of gold to pay for them. This exportation will gradually reduce the currency to its normal amount, as in the case of the early issues of inconvertible paper (page 123). But this restoration (whether by conversion or by exportation of gold) will sometimes be a slow process. Every bank that issues notes makes a profit on every note which it can get the public to take. Such a bank is in effect borrowing without interest, and what it thus borrows it can generally lend out and get interest for. It has thus a direct motive for issuing as many notes as it can induce the public to take; and although it cannot compel the public to take its notes, or to keep them in circulation, it may do much to induce them to do so. If there is only a slight depreciation, the loss on each note may be insignificant; and if the times are "good," and people are excited with hopes of high profits, they will sometimes be almost indifferent to such small losses. Thus it is in times of excessive speculation that there is the greatest likelihood of a somewhat depreciated currency being kept in circulation. This aggravates the fever and pushes prices to a still higher point than they would otherwise reach. Then comes the crash. Firms begin to fail: first, the rotten ones which have obtained undue credit in the general excitement; then other firms, whose position had been tolerably sound, are pulled down in their turn, and as the inflation of prices was aggravated by the amount of paper in circulation, so the reaction is proportionately more severe.<sup>1</sup>

<sup>1</sup> The significance of this paragraph will be better appreciated when the section on Panics (Chap. xii. Sect. B) has been read.

It was partly to obviate such dangers that the celebrated Bank Charter Act of 1844 was introduced by Sir Robert Peel. Its fundamental object was to limit the power of banks to issue notes. By it, the Bank of England was only allowed to have fourteen million pounds' worth of notes in circulation, in addition to its actual gold reserve; but when any other bank, having the power to issue notes, ceased to exist, the Bank of England was to be allowed to increase its note circulation by not more than two-thirds of what the dead bank had been allowed to circulate. Other London banks, and all banks started after the passing of the Act, were prohibited from issuing notes. Those provincial banks which existed when the Act was passed were allowed to continue issuing up to what had been their ordinary outstanding note circulation. By later Acts the Scotch and Irish banks were further allowed an additional note circulation equivalent to the amount of specie they held.

Under the provisions of these Acts, the total note circulation of the United Kingdom is now limited to about thirty-one million pounds, in addition to the actual reserves in the Bank of England and the Scotch and Irish banks.

It was hoped that the Bank Act would prevent the recurrence of panics. This hope has not been fulfilled; but we shall presently see reasons for believing that the intensity of such panics has been somewhat diminished by the operation of the Act. We shall also see why its effects have been so much less than its promoters expected.

## SUPPLEMENTARY READING.

WALKER, Chaps. viii. and ix.

## QUESTIONS.

1. Can notes that are convertible, become depreciated either as compared with gold, or as compared with things in general?

*Notice that a country where prices are high is a good place to sell in and a bad place to buy in. Both facts cause diminution in stock of gold. Conversion of notes and exportation of gold take time. In what circumstances would you expect longest time to be taken?*

2. What would be the effect of discontinuing the use of bank-notes?

*Would stock of gold increase? Why?*

3. Discuss the effects of the following proposals : (1) to issue £1 notes in England ; (2) to allow all banks to issue notes at will ; (3) to confine the right of issue to a single bank

*Under (1), notice convenience and effect on prices ; also fact that small notes are less likely to be converted when there is a small depreciation.*

*Under (2), notice both the effects of reckless and dishonest issues, and the points referred to in Question 1 on this Chapter.*

*Under (3), begin by ignoring vested interests.*

4. Under what conditions would an inconvertible paper currency be thoroughly satisfactory?

*Consider on what principles the amount to be issued should be determined.*

5. If England were engaged in a great war, consider the arguments for and against resorting to inconvertible notes.

*Notice the immediate conveniences and advantages ; and then the ultimate effects.*



## CHAPTER XII.

### CREDIT.



#### SECTION A.

##### BANKING.

WE have hitherto referred to bankers merely as issuers of notes. We must now briefly explain the chief other functions they discharge.

Functions of  
Bankers.

In modern society, at least in England, scarcely any one keeps much of his own money. Most of what a man receives, he generally pays into a bank, only reserving, at most, sufficient for small payments. When this is exhausted he draws a cheque, that is to say, he writes an order to his banker to pay a specified portion of his money to any one who presents the order. Tradesmen will often take such a cheque as if it were money, and their bankers accept it as such. This system has been found so convenient, that, in England, it has almost superseded all other modes of paying considerable sums. By various devices, which we need not describe here, the system of paying by cheques affords great securities against loss by theft or accident, as well as an excellent way of proving payments in cases where the receipt has been lost.

1) Providing  
safety for  
deposits.

Accordingly many people are glad to deposit their money in banks, even when they receive no interest for it.

A second function of bankers may be described as the cancelling of indebtedness. Let us suppose twenty-six persons (represented by the letters of the alphabet) who have commercial dealings with one another. A <sup>(2) Cancell-  
ing indebt-  
ness.</sup> perhaps owes money to B and D, and is owed

money by C, E, and F. Similarly, we will suppose that B owes money to E, G, and H, while money is owed to him by F and K; and so on for the rest. Now if these people all agreed on a single person to whom they should pay all their debts, and from whom they should receive whatever was owed to them, they would save much of the time, trouble, and expense that would otherwise be expended. If each person's debts were equal to his claims no money need pass at all, though the debts are due to one set of persons and the claims are due to others; and at any rate, no one need pay or receive more than the difference between his debts and his claims. If A, for instance, owes £500, and is owed £300, he need only pay in £200 to the person agreed on, who could then discharge the other debts out of what he got from A's debtors. A banker does actually discharge the functions of this single person, and the advantage he thus secures is increased by the fact that the different debts are due at different times. For suppose A received money to-day and knew that he would have to discharge a debt to the same amount next week, he would probably not be able to get any interest for it except through the intervention of a banker. The latter can obtain interest, for although he will have to make the payment next week he will also probably be receiving other moneys in the interval, and can

therefore, perhaps, safely lend out what he has received from A. Of course the banker must keep a reserve for contingencies, but experience shows that it is not necessary that this should be anything like equal to his whole liabilities. He will probably keep his reserve in the Bank of England, and should there come unexpected demands on him, the bank will willingly lend him what he needs, if his general financial position is sound.

This brings us to the third function of bankers. They borrow from one set of customers and lend to another. Sometimes they pay interest on what they borrow; sometimes the conveniences they offer are sufficient to induce people to deposit money with them. But in either case they lend out a large portion of what is deposited with them; and much of this would never have borne interest but for their intervention.

The chief ways in which bankers *borrow* have already been referred to. They issue notes and they receive deposits which they hold either for some covenanted time, or simply till they are drawn out by means of cheques. We must now briefly describe one of the chief ways in which they *lend*.

A *Bill, of Exchange*, like a cheque, is an order to pay, but, unlike a cheque, it is not addressed to bankers as such, and it is generally not payable at sight, but at some date specified on the bill. Bills of exchange were originally used to save the expense of sending the precious metals from one part of the country to another. Thus if £1000 were due from Londoners to people living in Newcastle, and a like sum from other people in Newcastle to other Londoners, it would save some trouble and risk if the debtors in each place paid the creditors in their own locality.

(3) Borrow-  
ing and lend-  
ing.

Bills of  
Exchange.

Each creditor might thus get what was due to him without any money travelling from either town to the other. The letters authorising such transfers of payment were called Bills of Exchange because they amounted to an exchange of debts. But at present bills of exchange are mainly used as a means of giving and receiving credit. It is usual in every trade to give a certain amount of credit. Suppose a shopkeeper buying goods from a wholesale manufacturer. He is allowed, let us say, six months' credit, so that he may pay for the goods partly or altogether from the money he gets for them from his customers. But suppose the manufacturer himself wants ready money. He can "draw a bill" on the shopman, payable at the end of the six months, and take it to a banker, who will give him the money after deducting his interest, or, to speak more exactly, the discount on it. At the end of the six months the shopkeeper will pay the full amount, so that the banker has in effect lent money at interest. It has next to be noticed that the essential feature of the transaction in no way depends on the existence of the goods supplied by the manufacturer to the shopkeeper. The two men might have been friends desirous of raising money on their joint security, but having no business relations with one another. The bill might nevertheless have been drawn in the same form, and have been "discounted" as in the above instance. Bills so drawn (as mere convenient ways of getting credit) are called "Accommodation Bills." They are not necessarily less safe forms of credit than those bills which are based on a transfer of goods. In both cases the value of the bill depends on the credit of those who are responsible for paying the money when the appointed time has elapsed. The goods supplied in our illustration were no real security,

for the shopman may have sold them and paid away the money long before the six months have elapsed.

It may here be noticed that bills of exchange do not necessarily go through a banker's hands. The function discharged by the banker in our illustration might have been discharged by a broker or other money-lender. Or again, the bill may pass from hand to hand as a sort of substitute for money. But at present we are only concerned with bills as one of the commonest ways in which bankers lend money.

A fourth function of bankers may be described as the remitting of money and the making of exchanges. But it will be best to reserve our explanation of this till we come to the subject of Foreign Trade.

The Bank of England is theoretically only one among many joint-stock banks; but it has certain privileges and functions which give it an unique position, and which may be briefly indicated. Of its privileges the most important are those already described in speaking of the Bank Charter Act, and those that grow out of the fact that the National Debt is managed through its agency; but its peculiar position is largely due to the fact that other banks keep their reserves with it, so that it is the bankers' bank. It discharges towards the rest nearly the same functions which they each discharge towards their own customers. In some cases these functions are discharged indirectly.

An institution known as "the Clearing House" cancels the mutual indebtedness of twenty-six City banks. Other banks each have one of these twenty-six as their agent, and thus transactions are brought together from all parts of the kingdom, and so far as

Clearing  
House  
System.

possible balanced against one another. To understand this system we may recur to the illustration near the beginning of this Section. We there took twenty-six persons, and showed how much these would gain by all treating one single person as if he were at once their sole creditor and debtor. If these twenty-six all have the same banker he may supply their need ; but if, as is probable, they employ different bankers, it is the Clearing House which ultimately acts as the single person through whom they balance their indebtedness. The cheque which A draws on a provincial bank is passed on to its London agent, and thence to the Clearing House, where it will perhaps balance a cheque drawn by B on some other provincial banker. The system seems very elaborate, but its essential features may be easily grasped. The student who desires a fuller explanation of them than is given here, or in the books referred to at the close of this chapter, must be referred to Mr. Bagehot's excellent little book entitled *Lombard Street*.

### SECTION B.

#### PANICS.

Modern business is largely conducted by means of borrowed capital. Wealth is thus placed in the hands of those who are, or are believed to be, most competent to employ it profitably. If the borrowers were Credit. always competent and honest, the advantage of such temporary transfers of wealth would be obvious and almost unaltered. Unfortunately it is impossible for a man to know certainly whether he can safely Abuses. trust another to make a wise use of capital, and in a complex

state of society the difficulties of forming a just judgment on the subject are often very great. As a matter of fact, those who possess wealth beyond what they intend to consume, frequently pass from unreasonable confidence to unreasonable timidity. At certain periods the large profits

made by men of business induce a confidence  
"Good Times." that passes easily into recklessness. All sorts of wild and speculative schemes are started, and secure the support of some of those having money to invest. Presently

the tide turns. Some catastrophe, like a war or  
Crisis. a famine, may give the first blow to the seeming prosperity; or it may be simply that the available capital has been absorbed, some of it wasted in unwise schemes, some of it sunk in forms that will ultimately be productive, but which as yet bring in little returns. Some of the more speculative and ill-conducted businesses will probably be the first to feel the blow. They cannot obtain the further capital they need, and without which perhaps they cannot continue working. Their failure not only gives a shock to credit; it also inflicts direct loss on those who have lent money to them. The loss will be more than some of them can stand, especially at a time when credit is contracting

\* Fresh failures follow. Each of them spreads disaster and ruin. A panic probably ensues. Firms which have not been either incompetent or dishonest, at least to any great extent, find themselves unable to meet their engagements. Every one is soon trying to contract his operations, to call in what he has lent, to sell any shares he

holds in businesses whose security is at all  
"Dull Times." doubtful. There is naturally a great check to production. Numbers of persons are thrown out of work.

Their poverty diminishes the demand for all sorts of commodities and all sorts of labour; and the country enters into what is called a period of depression, from which it only begins to recover when loanable capital has again accumulated and confidence has begun to revive. At first the revival will generally be slow; but at every step it expands the paper currency, and other forms <sup>Revival.</sup> of credit (like cheques and bills of exchange) which serve as substitutes for money. The effect is as if the currency had expanded; and there is consequently a rise in prices, which stimulates production and raises profits and wages. To some extent, no doubt, the rise is delusive, for it is a mere rise in money value, balanced by the corresponding rise in prices. But we have seen that, apart from this merely apparent rise, wages and profits (as distinguished from interest) really advance with a rise in prices due to what is equivalent to an inflation of the currency. Thus production and credit advance side by side till the credit given again becomes excessive and a fresh panic ensues.

The credit cycle which industry passes through between one panic and the next seems generally to take about ten years. Some writers have no doubt exaggerated the tendency of the cycle to occupy ten years; <sup>Cycle frequently decennial.</sup> and it must be admitted that there have been long periods when no such regularity has been discoverable. But it seems equally clear that the frequency with which a cycle has occupied about ten years is more than can be accounted for by chance. There were panics in 1711 and 1721. Then for forty years they came at irregular intervals; but then again the normal interval began to reappear. There were panics in 1763, in 1772-3, in 1783, in 1793. The



Great War seems then to have introduced a period of irregularity ; but after the Peace we have panics in 1816, 1825-6, 1836, 1847, 1857, 1866. If we turn for a moment to the case of other cycles through which the mind of man goes, *e.g.* in Politics or Religion, we shall find no approach to such regularity as this. Credit rests on opinion, and it is natural enough that over-confidence should be followed by undue suspicion, and that this again should gradually yield to a confidence growing with commercial success, and leading to a fresh period of wild excitement and speculation ; but it is difficult to suppose that the minds of men would tend to take the same number of years, *viz.*, ten, going through the cycle, unless there were some cause outside of the mind of man operating at decennial intervals. Such a cause may perhaps be found in the fact that the

**Sun-spot Theory.** Solar Period is 10·5 years, *i.e.* that it takes a little over ten years for the spots on the sun to recover their old relation to the earth. It is tolerably certain that their variations affect the Indian and many tropical harvests. It is still more certain that the various parts of the Commercial World are so linked together that a blow which falls on any one part is felt by the rest. A bad harvest in India leaves the natives barely enough to eat, and destroys, or greatly diminishes, their demand for English goods. This injures certain English trades, and the injury to these similarly diminishes the effective demand for the products of other industries. Thus the injury spreads in an ever-widening circle, and, even if the sun-spots only affect tropical climates in the first instance, there is no absurdity in connecting them with phenomena that are spread all over the industrial world.

It is not necessary for the theory to regard the Sun-spots as the only, or even as the chief, causes of credit cycles. It is enough to regard them as a regular force tending to establish a 'decennial period when no other forces intervene with sufficient energy to upset the periodicity. Among such forces we may indicate Wars, Inventions, Legislation, and the various causes that affect harvests. In some periods, as in that from 1793 to 1816, such disturbing forces are strong enough to destroy the decennial periodicity; at others, as from 1816 to 1866, they are only sufficient slightly to disturb the regularity of the periods. Thus the solar period is 10·5 years, but the interval between the panics of 1857 and 1866 was less than 9 years. If we test the theory, by taking comparatively distant panics, the results are tolerably confirmatory of it. Thus four solar periods (42 years) would take us from the panic of 1721 to that of 1763, and eight periods would take us thence to 1847.

In order to help students to understand the phenomena of Panics, we will here introduce a very brief historical account of two of these incidents. We will take first the Panic of 1847.

There had been unusually good harvests in the years 1842, 1843, and 1844. The consequent increase in production had added to the wealth available for commercial enterprises, and the low prices left money free Panic of 1847. for such purposes. Railways and steamboats were beginning to "pay," and to effect a saving of national wealth. There was so much loanable capital in the market that in 1844 the bank-rate sank below  $2\frac{1}{2}$  per cent., and even 2 per cent. This contributed, amongst other things, to a great extension of railways, which, even when they were productive in the

long-run, locked up for a time much capital in forms where it ceased to be loanable. Then came, in 1845, the first failure of the Irish potato crop. It was some time before the effect of these things began to be felt. But by the January of 1847 the bullion in the Bank of England had sunk below fourteen millions, as against over sixteen millions in the August of 1846. The Bank now raised its rate from 3 to  $3\frac{1}{2}$  per cent., and then, finding the drain on its reserves continued, there was a further raising to 4 per cent. Nevertheless, by April the reserve was below ten millions.

The rate was again raised, this time to 5 per cent. Meanwhile in 1846 there was a second failure of the potato crop; and in most parts of Europe the harvest was bad. **Bad harvests of 1846.**

Agricultural prices were higher than they had been for thirty-four years. There was consequently much speculation in corn, which temporarily inflated credit. But the large importations forced on a heavy fall in the price of wheat, which ruined many of the speculators. On the 9th of August, Leslie, Alexander and Co. failed with

**August 1847.** liabilities of about £500,000. On the 11th a couple of other firms failed, each with liabilities of about £200,000. Others quickly followed. Within three weeks there were failures to the amount of over three millions in

**September.** the corn trade. By the middle of September the ruin had begun to extend to other trades. Those bill brokers who had lent largely to corn merchants were naturally the first to suffer. They had to restrict their operations and to call in whatever capital they could. They thus dragged down many firms which might otherwise have pulled through their difficulties. These in their turn dragged down others. The extent to which capital had been locked

up in railways intensified the evil. The Bank not only raised its rate to  $5\frac{1}{2}$  per cent., but refused to lend on what would ordinarily have been regarded as good security. Towards the end of October, banks began to fail. On the 18th of October the Royal Bank of Liverpool had to close its doors. This brought down two other Liverpool banks. In Newcastle, in Manchester, and in other West of England places, bank failures occurred. October.

Consternation spread through the mercantile world. At length the Bank Act was suspended, and the mere knowledge that the Bank of England was free to issue notes at its discretion sufficed to stop the panic. The bank rate was now 8 per cent.; but the Bank lent freely, at high rates, when the security was good, and so saved a number of firms that would otherwise have fallen. It might perhaps have been desirable to suspend the Act somewhat sooner; but it should be noticed that many of the failures were inevitable. Under the influence of "good" times trade had become too reckless and speculative, and preventive measures would have been useless till the more rotten businesses had failed.

Let us pass now to the Panic of 1857. We must once more indicate some of the special features of the revival of trade and the speculative period which immediately preceded it. Panic of 1857. As is usually the case with panics, the crash of 1847 was followed by bad times. The contraction of credit impeded productive enterprises. Those who had money to lend were timid about lending it. But the capital which had been sunk in railways was now beginning to bring in returns. Savings were also accumulating as they were wont to do in times of caution. People began to recover from their fears, and to

get more and more impatient at the low rate of interest obtainable through thoroughly safe investments. Confidence slowly revived. Then came the Crimean War of 1854 to 1856, and the Indian Mutiny. As is usual with wars, trade was temporarily stimulated by what in the long-run was certain to diminish the resources of the world. In America, too, there was a Railway Mania, similar in some respects to the English one of the previous decade. Once more there was a period of excitement and speculation, especially on the other side of the Atlantic. It was there that the next crash began. There was a panic in New York, in which sixty-two out of the sixty-three banks in that city stopped payment. Many English houses suffered in consequence; and these, once more, spread failure around them. Liverpool and Glasgow were naturally the first to feel the shock from America. But the failures would have been comparatively few, if English trade had not been in an unduly speculative condition. As it was, the scenes of 1847 were repeated on a worse scale. The balance in the Bank of England sank below half-a-million. The Bank rate rose to 10 per cent. But for the suspension of the Act of 1844, the Bank of England must have closed its doors on Nov. 13, 1857. The suspension of the Act was once more followed by a cessation of the panic, but not till notes had been issued considerably in excess of what had been the limit under the Act. Then the cycle began again. A period of stagnation was again followed by a period of revival which developed into one of over-speculation, till the crash of 1866 once more brought the cycle to an end.

A few words may next be said as to the way in which Panics should be treated. A panic is almost identical with a great and sudden contraction of credit. Every-body is afraid to trust other people, and everybody is afraid that other people will not trust them. Everybody therefore wants to have his wealth in a form that shall be immediately available, and that for two reasons. He feels that any securities he holds may be depreciated or rendered valueless by the failure of those who are liable for them ; and he also knows that at such a time, his own creditors are more likely to press for immediate payment, and that owing to the contraction of credit he will find it unusually difficult to borrow. To meet the pressing demand of a crisis, much gold is naturally drawn from the bank, and the first step to meet the consequent danger should be to raise the rate of interest. This will tempt more people to leave their money deposited in the bank, and will induce others to deposit, by the prospect of a higher rate of interest. It will check the exportation of gold from the country, and will encourage the importation. The second part of the policy to be pursued is to meet the contraction of Credit by the suspension of the Bank Act. The essential object of that Act is to limit one form of credit (viz., bank-notes). In times of excitement and overtrading such limitation is probably beneficial. But it becomes an evil when credit is unduly contracted. The necessity of suspending the Act at such times is no condemnation of the policy of the Act. If it limits credit in speculative times, it confers a great benefit on the community, and although experience seems to prove that its effect in this direction is quite insufficient, it probably does really, to some extent, achieve

Treatment of  
Panics.

(1) Raise rate  
of interest.

(2) Suspend  
Bank Act.

its object. Its partial failure is due to the ease with which other forms of credit can be resorted to ; but it may reasonably be maintained that but for the limits placed on the issue of bank-notes, there would have been an even greater expansion of credit in 1846, 1856, and 1865, and a still more violent revulsion in 1847, 1857, and 1866. However this may be, the Act becomes worse than useless when a panic has set in, and the almost instantaneous advantage gained by its suspension has been clearly seen in each case when it has been resorted to.

The third principle in the treatment of panics is that the banks should be ready to lend boldly when the security is

(3) Lend really good, and the high rate of interest is  
freely on forthcoming. Unless this be done, many firms  
good are likely to fail whose business is, nevertheless,  
security. are likely to fail whose business is, nevertheless,  
in a substantially sound state, and who only need time to  
enable them to weather the storm. In this case, as in the  
other two, experience has fully confirmed the conclusions  
which we have defended on theoretical grounds, and the  
principles upon which panics should be treated are now  
generally accepted by all competent authorities.

It may here be noticed that there has been no suspension of the Bank Act since 1866 ; and that we are again in one of

Decennial " those periods when the regularity of the ten-  
Cycle again year cycle is interrupted. Among the causes of  
interrupted. this, a prominent place must be given to the  
appreciation of gold, and the concurrent fall of prices which  
have characterised the years 1873 to 1896. The falling  
prices prevented that general hopefulness which is neces-  
sary for a great general inflation of credit ; and this must  
be regarded as a partial compensation for the burden which  
the fall has undoubtedly laid on the producing classes.

## SUPPLEMENTARY READING.

WALKER, Chaps. x. and xi.

MILL, Book III., Chaps. xi. and xii.

## QUESTIONS.

1. Consider how far credit is an efficient substitute : (1) for money ; (2) for capital.

*Each question should be considered both from the point of view of individuals, and from that of the whole community.*

2. What should you consider to be the chief causes and effects of Commercial Panics ?

3. Should you expect the discovery of the fact that panics frequently occur at intervals of ten years to increase or diminish the regularity of their occurrence ?

*Consider how credit, production, and speculation would be likely to be affected by the expectation of a contraction of credit at a particular time.*



## CHAPTER XIII.

### FOREIGN TRADE

THERE are several distinct causes of International Trade. Thus the fact that some countries cannot produce a particular commodity may lead them to trade with the countries that can produce it. But, secondly, when a country can produce a particular commodity, it may be at a great natural disadvantage in producing the quantity of that commodity which it needs. England produces wheat, and it might perhaps produce sufficient for all its needs. But it could only do so by an immense expenditure of labour and capital. It is cheaper for us to produce other things and exchange them for wheat. Nominally, of course, we *sell* what we export, and *buy* what we import. But even if the money actually passed from country to country in the form of gold, the gold would be only a medium of exchange for bartering what we produce, in return for what we need.<sup>1</sup>

Thirdly, the disadvantage may be artificial. It may be due to the different aptitudes of different nations; to the amount of accumulated capital; to varieties of skill or tastes. Our manufacturing supremacy is partly due to our coal and

<sup>1</sup> Some qualification of this will be made further on.

iron, but partly to the fact that our thick population and large stock of capital enable us to avail ourselves of the advantages of manufacturing on a large scale. The economies thus secured often more than compensate for the cost of carrying manufactured goods to parts of the world which produce the raw material and could manufacture the goods in question. Were it not for the protective duties, it would certainly pay Americans to send us cotton to manufacture for them, although this involves that the cotton should be twice carried across the Atlantic.

It might seem that it is advantageous for each country to produce what it is best qualified for producing. But such a statement needs some qualification. In the years immediately following the gold discoveries in Australia, much cheese and butter was sent from Ireland, half round the world, to a country better fitted for producing cheese and butter than Ireland itself. Australia had rich pastures, but she had still richer gold mines. It paid her people to flock to the gold mines, and to pay the cost of carrying from Ireland what Australia was at least as well fitted to produce. No doubt if Irish peasants could easily have been transported in sufficient numbers to Australia, it would have paid best to produce both commodities, butter as well as gold, in Australia; but the difficulties that impede the flow of labour into the most remunerative channel within any country, operate still more strongly when it is a question of transporting labour to a distant part of the globe. It needs a considerable difference of remuneration to attract men to a remote country, or even to a country which is not remote, but where they would find themselves amid new and unfamiliar conditions of language and habits of life. The

A country  
may import  
what it could  
produce.

same applies, to a less extent, to the transportation of capital. The transfer is comparatively easy, but the difficulties in the way of secure investment, and still more of any effective supervision, prevent the equalisation of the rates of interest in different countries. It follows that in investigating International Values we are little helped by considering the cost of production. In the long-run, there is no doubt a *tendency* for values to move towards cost of reproduction, even in foreign trade. But the tendency is so slight that it may almost be ignored, and the main cause of foreign trade is a difference (not in actual but) in *relative* costs of production. Thus, in the illustration given above, Irish butter was exchanged for Australian gold, because gold could be produced relatively so much easier in Australia. The significance of this will appear more clearly if we take two countries, both of which can produce each of two commodities. Suppose that both in England and in France three tons of coals could be produced at the same cost as one ton of iron. The countries would not exchange these commodities, even if England had great advantages in producing each. But if France had a relative advantage in producing iron, it would pay her to send us iron for coal, though England might be able to produce iron for herself with less labour and abstinence than the production involved in France. This shows that there is no such connection between profitable trade and low wages as many imagine. Ask a "practical" man how it is that but for protection we could undersell American manufacturers in their own markets, and he will probably say that it is because American wages are so high; and similarly the sale in England of Belgian iron goods is popularly accounted for by the fact that Belgians will work

Owing to  
relative dis-  
advantage.

longer hours and for lower wages than our own countrymen. But these Belgian goods are evidently paid for in English goods. Even if the actual payment were made in gold we did not raise the gold in England; we presumably gave English goods in exchange for it, and therefore we ultimately paid for the Belgian goods by our own products: let us say, by cotton goods. Now let us suppose a general fall in English wages, and see whether this would enable us to undersell the Belgians. Our iron goods can, no doubt, now be produced more cheaply; but so can the cotton. Unless there be some change in the *relative* cost of production, it will still pay us just as well as ever to export cotton goods and to import iron goods in exchange; and even if this were not the case the change would only benefit the iron trade at the expense of the makers of cotton goods.

We will next briefly speak of the *economic* advantages of foreign trade. The intellectual and moral advantages of bringing men into contact with one another will not be dwelt on, as they only concern the economist indirectly; and of the more direct Economic advantages of Foreign Trade. economic advantages we will only observe that exchanges are normally beneficial to both parties. People often talk as if one party must lose by each exchange; but evidently both parties think it to their advantage, and although mistakes are frequently made, they must be regarded as the exceptions. Buying and selling are voluntary acts, and we may fairly assume that, as a rule, the goods Exchange beneficial to both countries. sold are worth more to the buyer than the money paid for them, while the money is worth more than the goods to the seller. The same thing holds between nations. In the example given above, England presum-

ably gained by buying iron, and also by selling cotton. This would be the case even if our forms of production were not influenced by the expectation of foreign trade; but in reality we each produced what we could produce with the greatest relative advantage, from the knowledge, or at least the expectation, that we could sell cotton, and buy iron in a way that would leave a profit to us. The Belgians acted with a similar knowledge or expectation; and in the majority of cases, such expectations are fulfilled. Trade is thus analogous to Division of Labour. It enables people to devote themselves to things which they can do (relatively) best, and thus secures not only the advantage of greater fitness, but also the advantage of more concentration. For even if there were equal fitness, it would often pay best for one party to work at one thing, and the other at another, and then to exchange portions of the products. We may notice that Trade may also lead to some of the disadvantages of Division of Labour. It is conceivable that a nation might devote itself too exclusively to a few things, and so not provide sufficient opportunities for various kinds of talent and capacity.

Let us next touch on the way in which nations discharge their liabilities to one another. This is chiefly done by a cancellation of mutual indebtedness. As a rule, it is in goods and not in money that nations pay for whatever they import. Suppose that of three countries (A, B, and C), A imported goods to the value of a million pounds from B, and B imported goods to the same value from C, and C from A. If the imports were paid for in gold, it would be necessary to send three millions in gold to discharge the liabilities, and, in the end, it would be found

that each country had neither more nor less of gold than at the beginning; for each would have sent and received a million. The cost and risk of sending all this bullion could evidently be avoided, if all the debtors had paid in their debts to some merchant in their own country, and that merchant had then paid the creditors in that country. This is what <sup>through Bills of Exchange.</sup> is practically done, only that instead of a single merchant in each country acting as intermediary, the work is done by various bill-brokers, who buy and sell bills of exchange, which are practically orders to pay, drawn on the several debtors by their creditors. People get what is due to them by selling such bills to a broker; they pay what they owe by buying similar bills. The broker gets a small commission, and the debts are discharged without any bullion passing from country to country. Hitherto we have been speaking of countries which owe the same amount, that they are entitled to receive though their debtors and creditors may be very unequally distributed among foreign countries. In practice, of course, this equality of debts and claims seldom exists, and we have next to ask what modifications of the system are introduced in consequence of the inequality. Let us suppose the total debts due <sup>Only the</sup> from English to Australian merchants amount <sup>balance need</sup> to seven millions of pounds, and the total due <sup>be sent in</sup> from Australians to Englishmen amount to five millions. If we exclude from consideration all other countries, we see that it is possible to cancel five millions of English indebtedness against the Australian indebtedness in the manner we have described above. This would save the cost and risk of sending twelve millions half round the world; but there are still two millions to be sent. Let us ask, therefore, who will

have to bear the cost and risk of sending this. If the merchants were all in direct relations with each other, it is plain that the Australians would be able to choose among the

The cost of sending falls on the country which owes most. English debtors a sufficient number to cancel their five millions of indebtedness. A competition would naturally arise among the English.

Each of them would be willing to pay some premium to be relieved of the cost and risk of sending the amount of his debt across the ocean. In practice the amount would be sent by English brokers; but they would charge a premium, in addition to their commission, in return for the service they were rendering to the English debtors; on the other hand, the brokers would be willing to pay some premium to each Australian debtor who buys from them, for such a bill diminishes the amount of the balance that has to be sent to Australia. In the case we have

Favourable and unfavourable Exchange. mentioned, the Rate of Exchange is said to be *against* England. The phrase simply means that people must pay a premium for the convenience

of bills payable in Australia, in addition to the broker's commission and the nominal value of the bill, and the explanation of this necessity lies in the fact that they are increasing the amount of Bullion that has to be sent half round the world. The rate of exchange is said to be *at par* when the indebtedness of the two countries is equal. In that case there is of course no premium to pay.

The rate of exchange, as explained above, is due to the balance of indebtedness. If, however, the currency of either country is debased (say, by the use of unconvertible paper), there will of course be a modification of the rate of exchange, since the nominal debt, reckoned in the debased currency,

will be greater than if it were reckoned in gold. It is therefore usual to employ the expression *real exchange* for that which grows out of the balance of indebtedness; and to speak of the *nominal exchange* when referring to variations due to the condition of the currency.

Real and  
Nominal  
Exchange.

If the relation between two countries were simply that of buying and selling, and if all payments were made in bullion, each country's imports and exports would be of the same value. This is implied in the very nature of a sale. If the only relation between England and America was that we bought cotton and meat to the value of five millions, and sold steel rails to the value of three millions; and if the excess were paid for in gold, it is evident that exactly two millions would have to be sent in gold. In other words, a country's imports, including bullion, are exactly equal to its exports, so far as these grow simply out of direct sales. But as a matter of fact we do not find this equality. The imports of the United Kingdom greatly exceed its exports. Taking, for instance, the year 1886, we find that the excess was over £80,000,000. In 1883 it was over £120,000,000; and although the excess varies from year to year, it always amounts to a gigantic sum.<sup>1</sup> Many people regard this fact with alarm. They say, in effect: "We are in the position of a man living beyond his income, of a manufacturer who habitually buys more than he can sell. We must be either running into debt, or steadily trenching upon our capital." In reality, however, we are doing neither of these things. A manufacturer may buy more than he sells,

Imports balance Exports so far as due to mere sales.

Excess of our Imports over our Exports.

<sup>1</sup> This holds whether we include bullion or exclude it.



and yet not be advancing towards ruin. His income may be partly derived from gifts (say from a son in the colonies), and partly from the interest on some capital he has invested, and partly from the remuneration for services he is rendering (say in carrying the goods of some other tradesman). Now

How the excess is accounted for. England is in the position of such a manufacturer. She has sons all over the world, who are sending gifts to their fatherland; she has invested much capital in foreign lands, from which she annually draws a large income; she does a large part of the carrying trade of the world, and receives of course a remuneration for this. And all these items, though nominally paid for in money, are actually, and in the long-run, defrayed in goods imported into our country, and against which there are no corresponding exports to set. The excess of imports over exports is therefore not a ground for alarm, but rather a matter for congratulation. In order to make this clearer, let us take in turns the three sources of income we have referred to:—

(1) *Gifts.* A youth has crossed the Atlantic and prospered as a colonist. He sends £20 a year to the old folks at home. He sends it in the form of a bit of paper, which is in effect an order on some English banker. But, as we have already seen, it is by no means certain that any gold will be sent from America to pay the remittance. It may be more profitable to send cotton. This ranks, of course, as an import into the United Kingdom, and accounts for a portion of that excess which some people regard with horror. In reality it is a free gift, a pure increase to the wealth of England.

(2) *Interest on Foreign Investments.* The same considerations apply to this source of national income. Englishmen

have invested money in foreign railways. They receive their interest nominally in money. But what actually comes to England may be any of the products of the indebted country. It swells the excess of imports, and is an enriching, not an impoverishing of the country.

(3) *Payment for services not embodied in commodities.* This item is more analogous to ordinary trade. When a country sends exports to pay for imports, it is really exchanging services for services. There is a similar exchange when the services rendered by either country are not embodied in commodities. Suppose America sent us only cotton, and received from us only cotton goods, but that the trade was all carried on by Englishmen, in English vessels, it is plain that the cotton would have to remunerate not only our manufacturers, but also our shipbuilders and sailors. There would be an excess of imports over exports; the fact would not be, as in the case of (1) and (2), a matter for congratulation; but neither would it justify any alarm.

The popular delusion on this subject grows out of that confusion between money and wealth, against which the student of economics must constantly guard himself. The popular idea seems to be that exports involve a profit, "because they bring money into the country"; but that imports are a questionable advantage. In reality a large portion of a country's imports are paid for by its exports, and if you diminish the one, you will probably diminish the other; while the rest of the imports and exports are accounted for by the sort of causes we have explained above. The excess of imports means simply that we are receiving more of the necessities, comforts, and luxuries of life than we are sending away, and this is, on the whole, a

Further  
analysis of  
the Excess.

matter for congratulation. It must of course be remembered that gifts, interest, and services, not embodied in commodities, help to swell the exports; and that capital invested abroad has, in the first instance, the same effect, though this is gradually more than repaid if the investment proves profitable. On the whole, therefore, we may describe our imports as representing the sum-total of the following items:—

- (a) What we receive in exchange for exports.
- (b) What we receive as interest on foreign investments.
- (c) What we receive as gifts from abroad.
- (d) What we receive for services not embodied in goods.
- (e) What we receive in exchange for any shares, or other securities transferred.
- (f) Any capital from abroad invested in the United Kingdom.

From this we have to deduct any unpaid debts, but this may be practically ignored, as there is no reason to suppose that, on the average, there is any great difference between the amount of bad debts incurred in international trade by our own merchants and those with whom they have dealings. Confining ourselves to the other items, it must be admitted that if the excess of our imports were largely due to the transfer of securities (e), there would be just cause for alarm; for this would really imply a living on capital. But there is no sort of reason for supposing that this is the case. The Income-tax returns seem to prove the very reverse. The excess is unquestionably due, in a great measure, to the excess of (b), (c), and (d), over the corresponding gifts, interest, and services received by foreigners from us.<sup>1</sup>

<sup>1</sup> What we receive under (f) is considerably less than the capital we send abroad. Otherwise the excess of imports would be even greater than it is.

On the whole, therefore, we should consider the great excess of our imports over our exports as a satisfactory feature in our economic position. Conversely in the case of India, the excess of exports over imports points to economic facts unsatisfactory to the country in question. Its exports are swelled by remittances for Anglo-Indians, and by the interest that India has to pay for foreign capital. The price may not be too heavy for the advantages of British rule and the improvements which the capital has effected; but it is evident that a price has to be paid for these things, and part of it takes the form of exports for which there are no corresponding imports. Even those who most deplore our own excess of imports will scarcely regard England as getting poorer than India, where the excess is the other way.

The Excess  
is gratifying.

Cf. India.

### SUPPLEMENTARY READING.

MILL, Book III., Chaps. xvii. to xxii.

### QUESTIONS.

1. How should you account for the fact that the foreign trade of Victoria diminished between 1856 and 1870, in spite of the increasing population and wealth of the colony?

*The best and most accessible gold mines were getting exhausted. The increasing population was making agriculture more profitable.*

2. Why is the premium caused by "real" exchange never greater than the cost of sending the amount in gold (including insurance)?

*Consider why any one is willing to pay a premium for a Bill of Exchange.*

3. How should you expect the exports and imports of two countries to be affected by the fact that the one was able to impose a heavy tribute on the other?

4. How should you expect the rate of exchange between England and America to be affected by a bad English harvest, assuming that the deficiency was largely made up by importation from America?

5. To what extent should you consider the foreign trade of a country to be a test of its prosperity?

*A country with no foreign trade might yet be very prosperous.*

6. How should you expect Irish imports or exports to be affected by the fact that so many owners of Irish land live out of the country?

## CHAPTER XIV.

### FREE-TRADE.

WE have seen that trade grows up on account of the different capacities of different countries. It enables each to devote itself to those forms of production to which it is relatively the better adapted, and to obtain in exchange for its surplus products a larger amount of other kinds of wealth than it could produce for itself with an equal expenditure of capital and labour. This being so, it might appear obvious that any interference with perfect freedom of trade was an injury to both the countries whose trade is interfered with.

It cannot be desirable for a government to encourage its own subjects to turn their industry and capital into less profitable channels than they would otherwise flow in.

It is possible, however, to conceive of cases where the interests of the community are so distinct from the commercial interests of individuals, that the former may be promoted by an interference with the free course of the latter. It is also possible that a government might judge more wisely than its individual subjects what would promote the commercial interests of the latter. We cannot, therefore, prove theo-

Theory of  
Free-Trade.

The inter-  
ests of the  
community  
may conflict  
with those of  
individuals.

retically that all Government interferences for the protection of native industries are injurious; but it may safely be said that the arguments usually relied on by those who

The usual objections to Free Trade are based on fallacies. call themselves protectionists, or fair-traders, are based upon fallacies. For these arguments when analysed are mostly based on the assumption that an excess of imports over exports is a

bad thing; that the importation of goods which we could produce at home is an injury to the nation, and an evil to

Imports not an evil. be deplored; an assumption which we have seen to be generally a delusion.

Thus Protectionists often say, "We are in favour of Free-Trade, if other countries will practise it too; but what we object to is, that we should admit foreigners' goods freely to our country, while they put taxes on our goods, or encourage their own products by the giving of bounties." Here there is obviously the assumption that the free importation of foreign goods inflicts injury on Englishmen; an injury which would, however, be compensated by an equally free admission of our goods into foreign lands. But in reality the free admission of foreign goods is (generally) a benefit to Englishmen. We pay for them, but the price is (normally) worth paying, and is paid, not in gold, or money of any sort, but in exported English goods (or services rendered for a remuneration). In some years, no doubt, we send out of the country more gold than comes into it, but this is rather the exception than the rule, and the balance is scarcely ever more than an insignificant fraction of our total imports, or of our total exports. To diminish our imports (normally) involves a diminution of our exports, except so far

as either represents a gift or the discharge of some liability. It follows, therefore, that to encourage one native industry by a tax or other burden on the foreign competitors, generally involves the discouraging of another native industry. The close connection between imports and exports may be illustrated by a comparison of the foreign trades of Protectionist Victoria and (compa- Exports  
ratively) Free-Trade New South Wales. The following table closely con-  
will show the value of the imports and exports (in millions nected with  
of pounds) at quinquennial periods :— Imports.

	Year 1867.	1872.	1877.	1882.	1887.	1892.	1897.
New South Wales, Imports,	6.6	8.5	14.6	21.2	18.8	20.7	21.7
„ Exports,	6.8	8.0	13.1	16.7	18.4	21.9	23.7
Victoria, . . Imports,	11.6	13.6	16.3	18.7	18.5	17.1	15.4
„ . . Exports,	12.7	13.8	15.1	16.1	11.7	14.2	16.7

We see from the above that thirty-five years ago New South Wales imported and exported little more than half as much as Victoria. The Protectionist policy of the latter has, of course, hindered the growth of imports (as it was intended to do). But the noteworthy thing is, that the exports of the colony have similarly been retarded. This is precisely what we should have expected, and it serves as a striking illustration of the futility of hoping to check the importation of foreign goods without simultaneously checking the sale of native products in foreign markets.

Let us next examine a little more closely the two chief methods by which governments have attempted to “protect” native industries. The first of these is by giving bounties on exports; the other is by imposing taxes on imports.

We will suppose the French Government pays (say) a



million a year in encouraging the French producers of sugar

by giving bounties on all the sugar they export.

**Effects of Bounties.** This million must, of course, be paid somehow by the French taxpayers. But the burden imposed on them does not end here; for the price of sugar will certainly rise, owing to the fact that either the supply of sugar in France is diminished, or else additional sugar is produced on more unfavourable terms, by resorting to inferior land, or applying more capital to the old land than it paid to apply at the old price of sugar. Let us suppose that the total addition to what is paid in France for sugar amounts to another million. So far, then, the French people have paid two millions for the sake of giving one million to a particular trade. But even this million will not all go to the producers of sugar. The rent of land suitable for beet-root will have risen in consequence of the lowering of the margin of cultivation. A slice of the bounty will thus go into the pockets of the lucky owners of this land. There will probably, however, be, at first, some addition to the remuneration of the producers of sugar. But this will tempt additional labour and capital into the trade. It will divert Frenchmen from the forms of production for which their qualities and the nature of their country fit them best, to one to which the Government has given a temporary prosperity at the expense of the French people. This will go on till the wages and profits of the sugar-producers are reduced to the level of those in other

trades (after making all allowances for difference in net advantages and difficulties). Let us

**Effects on us of Foreign Bounties.** next trace the effects of the Bounties on England.

If the policy achieves its ends, it enables French sugar-refiners to undersell the English. The English get their sugar

cheaper, but the English sugar trade may be ruined. This is not a light matter. For those who have acquired any of the particular forms of skill which the trade requires, and for those who have sunk their capital in sugar-producing, it may be a fearful catastrophe. Neither labour, skill, nor capital can be easily transferred to another trade. In some cases the transfer is impossible, and the French Bounty system may inflict ruin on many. Against this we have to remember that in addition to the gain to all consumers of sugar in England, the lowered price will probably increase the prosperity of other industries. The makers of jam, for instance, will profit by the cheapness. There will be more demand for English labour and capital and skill in this and other industries, and if we could be sure that the French Government would persist in its policy, the English people, as a whole, and in the long-run, would probably gain more than they lost by the French sugar bounties, even though some Englishmen suffered greatly from it. But unfortunately there is no security that the bounties will be continued. They may be kept up long enough to ruin the English sugar-producers, and then they may be removed, to the ruin, perhaps, of other industries that had grown up through the cheapening of sugar. In these circumstances, it is at least doubtful if England gains by imposition of bounties by foreign governments. What seems unquestionable is that France is injured by such a policy.<sup>1</sup> Whether the English Government can wisely retaliate by subsidising the English sugar-refiners, or

<sup>1</sup> Since this was written the Sugar Bounties have practically been abolished. Thereupon the price of sugar fell in France and rose considerably in England. Much injury was thereby inflicted on many English Industries. This was just what ought to have been anticipated.

by taxing imported sugar from France, is too complicated a question for discussion here.

We will next consider the taxation of imports, which is the second and more usual method by which governments have attempted to protect native industries. It is here necessary to distinguish between duties that are imposed only for purposes of revenue and those that are imposed wholly or partly to protect some home industry. An English tax on tea is in no sense protective,

(1) *For Revenue.* since there is no tea production in England.

Again, our duties on spirits are not protective, because they are balanced by excise duties on English spirits, and the amount of the two duties is intended to be such, that if both were abolished the home producer would be neither more nor less able to compete with the foreigner. We shall consider in a future chapter the advantages and disadvantages of such taxes as a mode of raising part of the revenue. For the present, we must confine ourselves

(2) *For Protection.* to what are really protective duties. The objection to these is very similar to the objection to giving bounties, viz., that they divert capital and labour to forms of production which are less suitable to the country than those which they would have been embarked in under a system of Free-Trade. If protective duties succeed in their objects they diminish our imports; but they would generally diminish our exports to about the same extent. If they secure employment for some classes of Englishmen, they limit the demand for other kinds of labour to about the same extent, and they of course raise the price of the articles on which the duties are levied. The advantage given to the protected industry is short-lived. For any

increase of profits or wages in that industry attracts fresh capital and labour to it, and the profits and wages are gradually forced down to the normal amounts. But the disadvantages of the enhanced prices are permanent.

A tax on imports falls mainly, if not exclusively, on the consumers, *i.e.* on the subjects of the government that imposes the tax. Suppose, for instance, that an untaxed import sells for a shilling. This means that a shilling provides a sufficient profit to induce the foreigner to send the article to our markets. Now let the government impose a penny tax on the article. Unless it can now fetch thirteence in the English market, the foreigners' profit will be reduced. No doubt for a time he may have to bear some loss of profit, owing to the difficulty of transferring labour and capital to other trades; but unless his profits were previously abnormal, the transfer will gradually take place. Less labour and capital will go into the business till its profits are brought to the old level as compared with others in the same country. It is possible indeed to imagine cases in which some portion of the tax will practically fall for an almost indefinite time on the foreign producer; but the amount so raised would hardly ever be sufficient to compensate for the injury done by the protective duties, though it is difficult to prove this in any general way. We will give here two historical instances of the effects of a Protective policy.

From 1815 to 1848 English Parliaments endeavoured to protect the Agricultural interest by taxing imported corn. The price of bread was kept artificially high, in order to save the British farmer from being undersold by foreign competitors. The evils which dear bread inflicted on the poor are within the memory of people now

Incidence  
of Import  
Duties.

The Corn  
Laws.

living; but it must not be supposed that even the producers of English corn enjoyed a compensating prosperity. In the years from 1820 to 1837 Parliament appointed five different Committees to investigate the causes and possible remedies for *Agricultural* distress. The condition of the labourers in the *protected* industry was miserable in the extreme. Landlords were able to pocket the whole advantage of the Corn Laws, and the people suffered that rents might be kept up. The protection of agricultural products can scarcely fail to have this result. If it temporarily raises the profit of farming, this will increase the competition for farms, and this will cause a rise of rents which will continue until farming profits are brought to their normal level. No doubt if farming profits have been temporarily brought below their level (say through increased facilities for importing corn), a temporary protective duty might really help the farmer during the years in which the consequent transfer of capital and skill to other industries was taking place; and there is much to be said in favour of attempts on the part of governments to diminish the miseries caused by changed conditions of trade; but attempts at doing this by protective duties would be likely to cause more evils than they removed. In this, as in many other cases, Protection may be theoretically defended, but only on the assumption of wisdom, knowledge, and strength in the Government, which in the present state of civilisation it would be idle to expect.

The condition of the American shipping trade will serve as an illustration of another kind of protection. An American shipbuilder has to pay duty on about twenty of the things he needs for making his vessels. In their effort to protect their own manufactures, the Americans have almost destroyed what was one of the

American  
Shipping  
Trade.

most promising of their industries. Few people would now defend the taxation of imported raw material. Every one sees that this is likely to injure the manufactures of the country. But it is not sufficiently noticed how many manufactured articles are themselves used as tools or materials for other manufactures. The objections to taxing them are similar to those that are felt to be fatal to the taxing of raw materials. A tax on *manufactured articles not used in production*, would certainly not be *as* objectionable as a tax on food or on the materials of industry; but even such a tax, besides raising prices, would diminish exports, and strike a blow at our shipping trade.<sup>1</sup>

Let us next consider what force there is in some of the common pleas for Protection.

(a) *To produce diversities of occupation.* In some cases it might be desirable to sacrifice something Pleas for  
Protection. for the sake of this. A country in which gold-digging was, economically speaking, the most productive industry, might feel that the social advantages of encouraging other industries more than counterbalanced some pecuniary loss. If, again, it could be established that the strength and health of Englishmen was suffering from the tendency of the people to gather in large towns and work in factories, it might be an advantage to protect the agricultural interest. Individuals are apt to seek immediate gains at the expense of the future.

<sup>1</sup> It must be remembered that such manufactured articles form only a very small proportion of our trade (about 30 millions out of a total of 350 millions imported, and as against more than 500 millions of goods manufactured at home for home consumption). If we imposed such duties as would altogether exclude such manufactured imports, the increased home demand would not be very great, and we have to set against this the diminution of our exports, the raised prices and the damage to our shipping trade.

The Government should take larger views. But even if it were desirable to interfere with that distribution of population between town and country, which competition and self-interest would bring about, it is probable that some better and less costly method than the imposition of duties on food could be found, especially as the latter would chiefly benefit the owners of agricultural land.

(b) *To make a country less dependent on others.* Here again, a good case might, in some circumstances, be made out for protection; though it has to be noticed that the mutual dependence of countries on one another is favourable to the maintenance of peace, and brings with it the advantages of intercourse. In the case of England, it must further be observed, that to secure independence we should have to produce about three times our present agricultural supply; a thing which, if not impossible, would at least involve a tremendous expenditure of labour and capital. Wheat would be raised to a famine price.

(c) *To balance high wages and heavier taxes.* The argument is that we have to compete with countries where wages are low and taxes light, and that "Protection" is needed to enable us to compete on equal terms. This of course assumes that protection is a gain. In reality, as we have shown, any benefit to the protected industry is generally short-lived, while the injury to other industries is permanent. If we at present compete at a disadvantage, we should only be increasing our disadvantage by imposing protective duties. High-waged countries generally beat others even in neutral markets.<sup>1</sup>

<sup>1</sup> This is largely due to the fact that the efficiency of labour is so much improved by better material conditions, especially when these continue for several generations.

(d) *For purposes of Retaliation.* Threats of retaliation, if successful, would extend Freedom of Trade ; if unsuccessful they would extend "Protection." The chance of success depends on very complicated circumstances. Tariff Wars have generally been disastrous. England's position is very favourable for such a War against certain countries on whom we are not much dependent for food and raw materials.

(e) *To give Preference to colonies in return for Preference given to England.* Economically there seems no reason why such a policy should not equally be applied to Foreign Countries. If England and Canada would both benefit by such an arrangement why not England and the United States. In reality, some industries in both countries would gain and others would lose, but the injury would be greater than the benefit.

(f) *To prevent "dumping."* Cheap goods are generally an advantage to the country receiving them, in spite of the injury they may inflict on particular trades. Cases can be imagined in which the injury exceeds the benefit. But such cases are rare, and difficult to deal with by Law without interfering with "dumping" that is beneficial.

(g) *To diminish the number of the unemployed.* Protection might give employment to some, but only by taking it from others, viz., those employed on the Exports which would have been taken in return for the Imports which a Tariff excludes. Our shipping trade would suffer both from diminution of Imports and from diminution of Exports.

(h) *The experience of Foreign Countries has satisfied them that Protection is wise.* But one chief motive of Continental Governments is to raise revenue in ways less unpopular than the imposition of direct taxes. They are therefore interested



in spreading the belief that their Protectionist Tariffs benefit native industries. The United States has Free Trade all over its 45 States which comprise almost every variety of climate, soil and natural resources. It is therefore comparatively independent of Foreign Trade and comparatively little injured by its Tariff. If these States were independent and hostile political entities, they would probably set up Tariffs against one another. Yet no reason can be given why identical commercial transactions between traders in two States should cease to be beneficial to both simply because the States had become politically independent.

On the whole, it appears that "Protection" can only be justified when a Government is so far ahead of its individual subjects in wisdom and foresight that it can dare to inflict economic loss on the nation for the sake of some (expected) future advantage, or to use a Tariff to break down prejudices which interfere with the most profitable use of labour and capital. Suppose the Indian Government imposed duties on manufactured cotton simply in order to protect Indian manufacturers. Such a policy would be foolish if India were relatively unsuited for such manufacturing; but if the only bar were native prejudice against new and unknown forms of industry we cannot dogmatically say that the policy would be unwise.

## SUPPLEMENTARY READING.

MILL, Book v. Chap. x.

## QUESTIONS.

1. "Protection would save much cost of carriage." Does this seem to you a good argument for Protection?

*Show that trade implies a saving, after cost of carriage has been defrayed.*

2. What can you say for and against a policy of imposing duties to establish an industry which is expected ultimately to flourish without Protection?

*Show that it might not pay individuals to establish an industry which would ultimately be a good thing for the country. Indicate the difficulties of withdrawing Protection. Can you suggest any alternative way of securing the end in view?*

3. Discuss the proposal to make the British Empire into a trade confederacy with Free-Trade among its members, but "Protective" against outsiders.

*Consider the gain and loss (1) to Englishmen, (2) to colonists. What view should you expect colonists who are protectionists to take of such a proposal?*

4. Does a country (generally) gain or lose by admitting imports freely, while other countries impose protective duties? Give reasons for your answer.

5. What reasons are there for making the introduction of Free-Trade gradual in a country when protection has been established?

*Indicate the effects of a sudden change in the kind of industry for which there is a demand.*

## CHAPTER XV.

### THE FUNCTIONS OF GOVERNMENT.

The primary function of Government is to define and protect the rights of its subjects.

The task of defining rights is by no means a simple one. Has every child born in the State a *right* to an education, and, if so, how far does that right extend? Has any man a *right* to own lands or other gifts of nature, and, if so, within what limits? <sup>1</sup> Has every generation a "right" to make arrangements binding on the next, and, if not, what are the limits to the "right" of each generation to repudiate the arrangements made by its ancestors? Has a starving man a "right" to food, if food is within his reach? or again, has he a "right" to sell himself into slavery? Has a man a "right" to marry as many women as may be willing to marry him? It would be easy to multiply such questions. The examples we have given will, however, be sufficient to illustrate the great difficulty of defining the rights, in the exercise of which a government should aim at protecting its subjects. But, in spite of all difficulties, the task must be attempted. The

<sup>1</sup> It is clear that if individuals have unlimited rights of ownership, the whole surface of the globe might come to be owned, and the owners would have a "right" to order the landless to depart from off the earth.

laws of every government are to be regarded as provisional definitions ; but these have constantly to be revised in the light of the morality of the age, and the views it takes of expediency.

Moreover, governments are not necessarily to be confined to discharging their primary functions. There are many desirable things which a community can do better through its government than by the private action of individuals. In England, for instance, the Postal system is probably better than that which would have grown up if the carriage of letters had been left to private individuals. Our towns are better lighted than they would be if all citizens were left to make such provision as they chose by voluntary action. Yet it can scarcely be maintained that men have a natural "right" to have letters under an ounce carried for a penny ; or a particular amount of artificial light in their streets.

Few people will be disposed to question that the test by which the functions of government are to be determined is mainly that of expediency ; though most would hold that this must be limited by a regard for moral considerations. If a balance of expediences seemed to favour the killing off of idiots or weaklings, most people would nevertheless protest against such a policy. On a similar principle, it is generally admitted that no individual ought to be left to starve in a community where there is sufficient for all. Apart, therefore, from questions of general expediency, the fundamental principle of the English Poor Law would probably be accepted ; but even here it is expediency that must determine the conditions and amount of relief given by the joint action of the community

to its indigent members. And if our space allowed us to examine the various subjects on which State interference can be justified or condemned, we should probably find that in each of these expediency was the main, if not the only test. \*

It is necessary to insist on this, because many people speak as if Political Economy condemned all State interferences that are not directly aimed at protecting the persons or the property of its individual members. Such a view could only be rationally maintained, if it could be shown that everything, except the direct protection of persons and property, is likely to be better done if the State abstains from interference with

Assumptions  
of *laissez  
faire*.

it. Such a view implies (1) that all people are the best judges of their interests, or, at least, that they are likely to judge better than the State,

(2) that the interests of the State are always identical with the interests of its individual members. Neither of these assumptions seems to accord with facts. With reference to the first, it has to be noticed that there is a large class (namely, children) who are plainly not competent to be the sole guardians of their own interests, and that, in many cases, experience proves that parents are not to be trusted with the sole care of these. To the children we must add many who from mental or moral incapacity must be placed in the same category. In the case of some governments, as in the case of British India, there is also a real presumption that, in some cases, the government will judge better than the governed of the interests of the latter. Nevertheless it may, perhaps, be

Partial truth  
of the first  
assumption.

admitted that if we confine ourselves to adults, and to such countries as our own, there is a strong *prima facie* probability that men will be better judges of their interests than the government can be; or, at

least, that it is better not to interfere with their judgments in the matter; that if they make mistakes they had better be left to learn from experience, rather than have their conduct interfered with by government, so long as they do not encroach upon the like liberty of others. I say, *in such a country as ours*; but I am not prepared to say that the attempts made by English Governments *in former ages* to regulate prices, wages, and methods of work, have invariably failed, or done more harm than good. But the increased complexity of business that followed on the Industrial Revolution at the close of the last century greatly aggravated the difficulties of wise Government interference. The introduction of modern forms of machinery, which have resulted in our factory system, the improved means of communication which have established close commercial relations between England and almost all parts of the world—these and other forces have compelled our Government to relinquish attempts which, for centuries, it made with some success; and it may fairly be hoped that the spread of intelligence and education have helped to turn the balance against government interferences in the direct interest of its adult subjects in our own generation.

The question is less certain when the interest is not immediate. There are many in our midst who are under the strongest temptation to make the best terms they can for the present, and to leave the future to take care of itself. It has, for instance, been thought necessary to pass Truck Acts to prevent, or limit, the payment of wages in goods; although it might plausibly be maintained that workmen were likely to judge for themselves, far better than the Government could, what kind of remuneration they would covenant to work for. But when we pass on to consider the

second assumption which lies at the bottom of the doctrine of *laissez faire* (the doctrine that Government had better confine itself to the direct protection of its subjects from fraud and violence), we shall find that it cannot be accepted. The "economic" interest of each generation is to get for itself as much wealth as it can from the materials and tools at its disposal. The "economic" interest of each individual is similarly limited to his own power of amassing wealth. But the Government is the trustee for the future as well as for the present. It is bound to husband the national resources, and to protect them, if not against the short-sightedness of individuals, at least against their selfish neglect (complete or partial) of the interests of posterity. Now of all the national resources, the most important is a strong, healthy, skilful, and moral population. Some of our colonies might serve as good examples of the fact that a country which is wretchedly poor, while inhabited by men in a low stage of civilisation, may become rich and prosperous when another race settles there. Regions which could barely support a handful of savages can provide sustenance for millions of civilised men. The gifts of nature lay open to the grasp of the former, but these knew not how to utilise them. Or again, if we limit ourselves to a comparison between nations that we count civilised, the most cursory view will suffice to show that the physical and mental qualities of the population are, at least, among the most important facts determining the amount of the national wealth. The husbanding of these, the chief national resources, by general and technical education, by sanitary legislation, and other protective measures ; by diminishing the fluctuations of employ-

Fallacy of  
the second  
assumption.

Husbanding  
national re-  
sources.

ment; by providing work, when possible, for those who are able and willing to do it; by distinguishing between the deserving and undeserving paupers, and saving the former from the indignity of being classed with the latter; these are, even from a purely economic point of view, among the objects that a government should set before it. The task may, in some cases, prove too difficult. England, at present, owns herself incapable of providing work for those willing to do it, and of making an adequate distinction between deserving and undeserving paupers, without doing mischief more than equal to the good she could secure. It is not possible in a short text-book like this to weigh the reasons for and against the judgment which our rulers have arrived at on these matters; but at least it ought to be acknowledged as a blot on our civilisation that we do not see our way to doing anything in these directions by State action. In Education and Factory Acts, Sanitary Laws, etc., we are doing something. Here again we should transcend the limits set to this book, if we attempted to discuss how far we are doing wisely what we do; and how far there is more to be wisely done. We will only notice that Political Economy is far from condemning State interference in these directions. They may be justified<sup>1</sup> either as a husbanding of our human resources, or as a doing by collective action, what voluntary action would not do as well.

<sup>1</sup> The material resources of a nation may also often with advantage be protected from a destruction that would be brought on them by the short-sighted greed of individuals, or by their disregard of the interests of future generations. The Pollution of Rivers Act of 1876, and the Alkali Act of 1881 may be mentioned among the measures by which our Parliament has recently sought to fulfil the function. Among the Acts which aim at the protection of our human resources, the Mining Acts and Artisans' Dwelling Acts, would, of course, be included.



A few words must be here introduced as to the disadvantages of State administration. These grew chiefly out of the absence of competition, and of the sort of self-interest which gives efficiency to the administration of much of the business of our country. The absence of competition is not an unmixed evil. If it withdraws a stimulus, it saves much waste. The Post-Office arrangements will illustrate this. If the work were left to voluntary agencies there would probably be several competing companies covering much of the same ground. This would involve much useless expenditure, and though the public would gain something by the competition between the companies, it is probable that most of the advantage would be lost by the ease with which the companies could come to an agreement with one another. Experience shows that when there is a possibility of combination, competition ceases to be effective, and the objections to a government monopoly are greatly diminished. In the same way there are real disadvantages in the growing tendency of towns to manage their own gas and water supply; but experience seems to show that these are more than counterbalanced by the advantages of municipal administration. If these undertakings were in private hands there would practically be little competition, and although self-regarding motives are less operative where the profits do not go to the actual administrators, it does not follow that this leads to such loss of efficiency as would balance the gain of having these works under public control and managed in the interests of the public. It may be noticed that there is at present a tendency for many kinds of business to pass into the hands of joint-stock companies, which are subject to most of the same disadvantages as a

public body. In both cases the profits do not go directly to those who actually supervise the work, and yet in many forms of business it is found that companies are more successful than private capitalists. It may reasonably be argued that there is a similar tendency for the progress of society to diminish the disadvantages of Government management; even apart from the growth of public spirit and of the more intelligent control which constituencies may be expected to exercise over their representatives and the officials who are their servants. On the other hand, there can be no doubt that government and municipal work is often badly done; that it is often tainted by jobbery and throttled by red tape, and that its machinery is often cumbrous and wasteful. It must not, therefore, be assumed, that because our central and local governments undertake with advantage many functions which were formerly left to private agency, *all* extensions of their functions are to be approved. In most cases it is only experience that can finally determine the gain and loss of such extensions. But the considerations mentioned above should mitigate the well-grounded distrust of proposals for extending the sphere of government. Each proposal has to be judged on its own merits; but it has to be remembered that the greater regularity of employment must be counted among the advantages of extending the functions of public bodies. Irregularity of employment is among the worst evils from which our working classes suffer, and anything which diminishes this, is worth paying a price for. It has next to be noticed that the advantage of extending the functions of government often depends partly on whether the system of taxation is good. Take for instance, a proposal to improve

Bearing of  
Taxation on  
Functions of  
Government.

the education given in elementary schools, in a way<sup>h</sup> that will add to their cost. The desirability of such improvement may be unquestionable; but it has to be balanced against the expense; and the question arises who will have to bear this additional burden. The subject of taxation must be deferred to a later chapter, but it may be noticed that a change in the system of taxation might make much expenditure desirable which in present circumstances would place an excessive burden on industry.

### SUPPLEMENTARY READING.

MILL, Book v. Chap. xi.

### QUESTIONS.

1. Consider the arguments for and against the following (for such a country as England):—

(a) The State owning and working Railways.

(b) Municipalities starting Relief Works in times of special depression.

(c) The State fixing a maximum of wages, or a maximum of hours of labour.

(d) State-aided Emigration.

2. On what principles, in your opinion, should the State give relief to the destitute?

3. Discuss whether those who have no children may fairly be taxed to support schools for the education of other people's children.

4. Distinguish between the necessary and the optional functions of government. Under which should you place the issue and regulation of the currency?

## CHAPTER XVI.

### TAXATION.

GOVERNMENTS evidently need money for the discharge of their various functions. The question how that money can be most wisely and justly obtained is one of some difficulty. It involves<sup>1</sup> three distinct problems: (1) In what proportion should the members of a community be asked to contribute to common purposes? This is a question of *equity*. (2) How shall it be ensured that the taxes actually fall on those from whom it is intended to draw them? For we shall see that people are often able to shift on to others the taxes that are paid in the first instance by themselves. This is a question of the *incidence* of taxation. (3) There are questions of convenience and economy. Some taxes cost far more than others in the collecting; and some *seem* to be or actually *are* more burdensome than others which produce an equal amount for the State.

Apart from these three problems we may notice that it is

<sup>1</sup> In practice governments sometimes possess land or other forms of property which produce a revenue. They also often obtain funds by borrowing. We confine ourselves in this chapter to revenue obtained by taxation.

sometimes thought desirable for government to interfere by means of taxation with some forms of consumption that are considered hurtful to the community. Thus taxes on alcohol, opium, etc., may be imposed simply to increase the cost of obtaining these means of gratification.

On the question of Equity, there seems to be a growing tendency to regard it as among the functions of government to do *something* towards redressing inequalities

Taxing the  
rich for the  
poor.

of wealth. The principles of our Poor-Law and

Education Acts may be defended on various grounds, but they evidently involve the idea that the State is in some cases justified in taxing the rich for the direct benefit of the poor. So again, we exempt from the payment of Income-tax those whose income is less than £150 a year and we deduct £120 from all incomes under £400 and only charge the tax on the remainder. There are obvious dangers in carrying too far this principle of taxing the rich for the benefit of the poor. There are for instance the dangers of driving capital and business ability out of the market, and of encouraging idleness, thriftlessness and reckless marriages. One of the most difficult problems of statesmanship in democratic countries will probably be that of deciding how far the principle to which we are referring can safely and justly be carried. But any full examination of the question would take us far beyond the limits of an introductory text-book.

Passing next to the question of Incidence, we have said

Incidence  
of indirect  
taxes.

that the burden of a tax is often transferred from the person who originally pays it. This is obvious in the case of what are ordinarily called

"indirect" taxes. If a government imposes a tax on some

commodity (say on tea), the sellers of tea must in the first instance submit to a diminution in their profits unless they can raise the price by the full amount of the tax and sell as much tea as they did before. If they can do this, they are transferring the whole of the tax to the consumers. If there is a fall in the profits of the sellers, labour and capital will gradually be transferred from the trade, or at least their flow into the trade will be checked. This process will continue till the profits have been brought up to the level of those in other trades of a similar character. In the long-run the fact that there is a tax on tea will not injure those engaged in the trade, more than it will injure those engaged in other trades of nearly the same grade. The tax will either fall on the consumer, or be distributed over a number of trades. But it is not merely (so-called) indirect taxes whose incidence can thus be shifted. Thus a tax imposed on capital or interest may fall partly on the wage-earning classes. For such a tax may diminish the accumulation of capital, or lead to its going abroad, and this will tend to raise the rate of interest at the expense of the wage-earners, as well as of those who actually borrow. Similarly a tax laid upon wage-earners may be partly transferred to employers and partly to capitalists, especially if it affects the population by delaying marriages, lowering the birth-rate, increasing emigration, or raising the death-rate. It is evident however that such results are uncertain. We have seen that a fall in the rate of interest actually increases some of the motives for saving; and that poverty sometimes encourages recklessness and saps the energy of a people; but even apart from these opposing forces there is too much uncertainty about the

Incidence  
of taxes  
on capital;

and on  
labour.

Uncertainty  
of diffusion.

operation of the diffusing laws—too much friction, so to speak, and immobility of labour and capital to enable the transfer to be confidently anticipated, at least within any moderate time. On the whole, if there is a tendency for taxes laid on any particular class to be diffused over the whole body of the community, there is also a tendency for an undue portion of the burden to remain where it was originally placed.

It may next be noticed that there is one important class of taxes, in which there is little or none of the diffusion to which we have been referring. Taxes on land cannot, as a rule, be transferred wholly or partly by the landlords to their tenants, or to any other section of the community, at least when competition is keen. The reason why a tax on tea can be partly or wholly transferred to the consumers is, that the importation of tea will be diminished, unless the public will pay a price that will cover the tax after providing normal profits to the tea-dealers. The growers of tea will similarly need normal profits to induce them to keep up the supply. But of *land*, the supply in any country is a fixed quantity. The demand for it is not affected by the tax. There is nothing, therefore, to alter the price obtainable for its use. In other words, the landlords cannot recoup themselves by raising rents. Even if the tax has to be *paid* directly by the tenant it will ultimately and in the long-run fall on the landlord. A landlord who could get £50 as rent for untaxed land, will only be able (normally) to get £40 if the tenant knows he will have to pay a tax of £10 on it. It may be necessary to remind the student here that this argument does not apply to the “rent” of houses and improvements, which indeed, are not “rent”

Incidence  
of taxes on  
land.

in the economic sense. A house-tax may check the building of houses, just as a tax on tea may diminish the importation of tea. But the "rent" of a house consists theoretically of two parts. One portion represents the annual value of the land, and this portion is subject to the forces which we have been considering above. The other portion is properly interest on capital, builders' profit, and payment for depreciation. The supply of houses will not be kept up unless builders can get normal remuneration for their labour and capital. A tax on this second portion of rent will therefore be transferred to the consumers, i.e. the tenants. A concrete example will help to explain the incidence of Taxes or Rates estimated on the annual value of houses. Let us suppose a house rated at £50, of which £20 corresponds to the annual value of the land on which the house is built; and let us suppose that there is a rate or tax of 5s. in the pound on the house. The tendency in the long-run will be for 2s. in the pound to fall on the landlord, and 3s. in the pound on the tenant, whether the rate is actually paid in to the collector by the one or by the other. It is mainly a matter of convenience, whether such a tax shall be levied from the landlord or the tenant, except so far as leases, ignorance, stupidity, etc., delay or prevent the operation of competition. In cases where there is a lease it is plain that the party on whom the tax is imposed will have to bear the burden; but when the lease has expired the terms of any new arrangement will be made with the knowledge of how and by whom the tax has to be

Incidence of  
rates and  
house-taxes

The questions of convenience and economy which affect the



choice between different taxes and different modes of collecting them are too varied and complicated to be treated of here. I think it will be best simply to say a few words on some of the chief classes of taxes taken in turns :

1. *Customs and Excise*.—We have seen in a previous chapter that it is generally inadvisable to impose taxes on imports for the sake of encouraging native industries. This does not, however, involve the condemnation of Customs duties, levied simply for purposes of Revenue. Any "protective" effects of such a tax can be avoided by imposing a corresponding "excise" duty on the home product. Thus we balance our customs duty on Foreign spirits by a corresponding excise duty on British spirits. Taxes on alcohol, opium, tobacco, etc., are generally levied, not merely for purposes of revenue, but also in order to check habits regarded as involving moral and physical dangers. The advantages and disadvantages of such interferences with special forms of consumption will not be discussed here. Limiting ourselves to other considerations, we will notice that Customs and Excise duties may be defended on several grounds, such as that being ultimately paid by consumers in the form of slightly increased prices, the burden is not perceived to anything like the same extent as that of equivalent direct taxes would be ; or again, on the ground that these taxes can be easily limited to articles of luxury. Against this, we may notice (a) that it is a questionable advantage that taxpayers should not realise what they are paying. The concealment may diminish dissatisfaction, but it is likely also to diminish the checks on national extravagance. (b) Indirect taxes generally involve greater expenses of collection than do equivalent direct taxes,

and even apart from this, the rise in prices which they cause is generally more than equivalent to what government obtains. In many communities it can scarcely be questioned that it is desirable to raise part of the revenue by indirect taxation; but as these communities advance in civilisation, public spirit, and intelligence, the proportion which direct taxes bear to indirect will probably increase.

2. *Income-Tax*.—There is an evident simplicity about making each man's contribution to national purposes depend on the amount of his income. The tax may be made strictly proportional, or progressive on larger incomes; or any system of exemptions and modifications may be adopted according to the prevailing ideas of equity or expediency. But it is almost impossible to discover the exact incomes of many persons. If a government relies largely on the returns made by the persons to be taxed, a premium is evidently given to dishonesty. Attempts to prevent falsification are apt to be resented. In countries where it is considered important to conceal the burden from the taxpayers, an Income-tax is of course a specially undesirable way of raising revenue.

3. *Land-Tax*.—A land-tax is, in many respects, the best form of taxation. We have seen that as a country advances in population and industrialism there is every probability that the value of its land will rapidly increase, especially that of the land on which its towns are built. In a country like England, this "unearned increment" would amply suffice to defray all the expenses of government, and if this increment had been reserved for the State there would be no need of other taxes. The whole revenue would then be raised in a way that would not press on capital or labour; and the nation would have, for national purposes, the amount it has

added by its labour and thrift to the value of its land. It does not, however, follow that it would be right or expedient, in present circumstances, to transfer the whole burden of taxation on to the landowners. It must be remembered that those who have purchased land have purchased, under State sanction, whatever increment of value the land might receive in subsequent times. One of the hardest problems of statesmanship is to reconcile the legal rights established in the past, with the rights and interests of successive generations. To ignore the former would certainly involve serious economic evils, apart from the terrible hardships it would inflict on individuals.

4. *House-Tax*.—Taxes and Rates estimated on the value of dwellings, are open to the serious objection that they discourage a most beneficial form of expenditure. It would probably be desirable to exempt the dwellings of the poorer classes from all rates<sup>1</sup> and taxes, so as to remove impediments to the better housing of the poor. Rates proportioned to the value of the *land* on which the houses are built, would not be liable to the same objection.

5. *Death Duties*.—It may fairly be questioned whether any tax whatever should be paid on the inheritance of a wife or young child. In the case of these, the death generally involves a serious pecuniary loss, and the time is specially inappropriate for imposing an additional burden. On the other hand, an inheritance passing to an adult son, or to a more distant relation or friend, may reasonably be charged with a contribution to the State. When the inheritance is large, the tax might be made more than proportionally

<sup>1</sup> Water-rates and similar payments for conveniences are not of course included here.

heavy; but it is important to bear in mind the danger that heavy duties may lead to evasions by means of gifts before death, which would deprive the State of all share in the property. Property not disposed of by will might reasonably pass altogether to the State when there is no very near relative to inherit.

These brief notes are only intended to indicate the chief advantages and disadvantages of the forms of taxation to which they refer. In England it is thought advisable to raise the revenue from a variety of sources. Thus for the estimates for 1904-5, the Chancellor of the Exchequer proposed to raise about 36·5 millions of pounds from Customs duties; about 31·5 from Excise; 13 from Death Duties; 2 from Inhabited House Duty; 30 from Income-Tax. The rest of the revenue was to be derived from profits on the Post-Office; rents of Crown lands; and other sources, most of which can scarcely be included under taxation. Our local expenditure is mostly paid for by rates on house values.

#### SUPPLEMENTARY READING.

MILL, Book v. Chaps. ii. to vi.

## CHAPTER XVII.

### SOCIALISM.

SOCIALISTS advocate an extension of the functions of Government. The extreme Socialist desires that all land, and all or most kinds of capital, should be owned by the community, and administered by the Government. The State is to regulate all or most branches of industry, and to decide how the product shall be distributed. More moderate Socialists advocate only a limited interference with individual freedom. It seems desirable to confine the name "Socialist" to these two parties, and to exclude all merely voluntary co-operations, and all mere aspirations for a more equal distribution of wealth, leisure, and opportunity.

We have now to ask what Political Economy has to say, (1) to proposals to practically transfer to the Government both the production and distribution of wealth, and (2) to proposals which would involve merely an extension of the sphere of Government in matters industrial.

On the former question it must suffice to say, that as long as human nature remains substantially the same, a complete socialisation of industry would be disastrous, because it would so greatly diminish the production of wealth, that in a country like ours the population could hardly be supported. At present the desire for wealth

is one of the most powerful factors in stimulating industry. Much work is, no doubt, done from other motives. But it is difficult to see how any serious thinker can suppose that adequate pressure could be exerted without the stimulus of self-interest and family affection. A rigorous socialistic despotism might enforce labour, but could not compel the putting forth of those mental powers which play a large part in the production of wealth. A love of work for its own sake, or a fervent altruism, will sometimes suffice to call out a man's best energies. But neither of these is at present sufficiently powerful, in the case of the majority of men, to replace the self-regarding motives. Whether human nature is ever likely to be so modified as to make the Socialistic State practicable, is a question which cannot be discussed here.

Turning now to the more moderate kinds of Socialistic proposals, it is important to distinguish between the following eight distinct varieties :—

Partial  
Socialism.

I. Certain industries might be conducted by the State or by Local Authorities under conditions generally resembling those that prevail in businesses conducted by private employers. Railways might be nationalised, or tramways municipalised, from the same sort of motives which have led to the establishment of our National Postal System. The desirability of such extensions must be decided on the principles laid down on pp. 178 and 179 of this book.

Transfer of  
Industries.

II. But the State might conduct such industries as it undertook, not merely for the benefit of the public, but for the special benefit of those whom it employed. It might pay more than the market rate of wages, or be satisfied with shorter hours of labour.

The State  
as Model  
Employer.

This form of Socialism seems unjustifiable, at least if it is carried far. The State must indeed be careful not to fall behind private employers in the conditions under which it gives employment; but if it pays a man considerably more (in money, or otherwise) than what he would receive in the open market, it is merely establishing a system of favouring one set of its subjects at the expense of the others. Such a system would be a most fruitful source of jobbery, and this again would impair the industrial efficiency of the work. It must be remembered, too, that any considerable favouring of State or Municipal *employés* increases the difficulty of extending State and Municipal agency. It might be advantageous to nationalise railways if the administration were to be carried on on ordinary business principles. But if wages were to be raised and hours of labour shortened beyond what would have been practicable and desirable under the system of private enterprise, the cost might well be more than the State would or should be willing to pay.

Hitherto we have dealt with socialistic proposals involving a transfer of industries from private to public hands. We have now to speak of proposals for State interference with industries which are left mainly to private enterprise.

III. One of the most instructive of these is the proposal to limit the hours of labour by legislation. The difficulties of such interference are great. A uniform maximum for all trades would be unfair to those whose work is especially heavy or dangerous. A variable maximum would involve a most difficult discrimination. If the maximum were placed too low, the trade affected might be ruined. Many industries could not provide a living wage

and a minimum profit if the hours of labour in it were limited to (say) eight. Blunders might be fatal, and yet it would need something like infallibility to avoid them. On the other hand, it must be admitted that in some cases a legislative interference might increase efficiency, at least in the long-run. It is conceivable, for instance, that if no miner might be employed underground for more than eight hours, the resulting losses would be more than counterbalanced by the gains. Some risk there must be. But if a considerable majority of those engaged in the trade were prepared to run the risk, a strong case may be made out for allowing them to do so. The coercion of minorities is often necessary in the interest of the majority. We are again driven to the somewhat lame conclusion that each case has to be tried on its own merits. The dangers, however, of legislative interference with the hours of labour are so serious that they should hardly be run without proof, (1) that the present hours are so long as to be hurtful to health, (2) that a large majority of the workers favour the interference.

IV. The difficulties in the way of legislative interference with wages are still more serious. The demand for a living wage seems pre-eminently reasonable. But unless the Government will provide work it can hardly insist on a minimum wage. If it lays down a minimum, it cannot compel any one to offer employment at this rate. A Government that undertook to provide work, at reasonable wages, would find itself driven to take over industry after industry. It must be prepared to establish the completely Socialistic State, which in the present state of human evolution seems impracticable, or at least undesirable.

V. Other direct interferences of Government with the



private management of business are seen in Factory Acts, Employers' Liability Acts, and similar measures. These raise far too complicated questions of detail to be adequately discussed in this short treatise. It must suffice to say that every such interference, involves real evils. The mere multiplication of inspections and inspectors is a costly charge on that National income from which wages have to be paid. The hard and fast rules which a Government lays down are often unsuited to special cases. There is evil too in the transfer of responsibility, and in the temptation to evasion. Employers and Employed often combine to break the law and to deceive the inspector. But after every such allowance has been made, the balance of competent opinion is strongly in favour of much Government interference. Mistakes have been made, but it is probable that our Factory Acts need extension rather than contraction, or, in other words, that, in this respect, it is desirable for us to become more Socialistic.

VI. Hitherto we have spoken of *direct* interferences. Of the *indirect* interferences, perhaps the most important are those connected with Education. We deliberately tax some people to pay for the education of other people's children. We deliberately compel children of certain ages to go to School. No part of our polity is more distinctly Socialistic. But while most kinds of Socialism tend to interfere with private enterprise, and to limit the struggle for existence, it may fairly be contended that, in this case, Socialism tends in the opposite direction. By fitting children for the struggle of life, by developing their intelligence, and other industrial qualities (physical, moral, and intellectual), we are ultimately encouraging private enterprise and energy

and all that is best in Individualism. An educated nation can afford to be more Socialistic than an uneducated one; and heavy as is the cost, we should be wise not to trouble ourselves so much about this, as about the question of the result. The State which has the best, though not necessarily the most showy, system of Education will have little reason to grudge any expense which it has incurred. Increased knowledge, skill, industry, and honesty add far more to the wealth of nations than is expended in developing them.

VII. Very similar considerations apply to questions of sanitation. So far as these concern factories, workshops, and mines, they fall within the fourth of our groups. So far as they concern homes, they only in- Sanitation. directly affect Wealth production. In this case, as in the last, so long as we get our money's worth, the actual cost need not greatly alarm us.

VIII. Our last group of Socialistic institutions and proposals is even more distantly related to the Production of Wealth than the sixth and seventh. It is The Aged and Incompetent. concerned with the support of the Aged and Incompetent. It includes the Poor Law, and such proposals as Old Age Pensions. Even these, however, indirectly involve interferences with Industry. A system of Old Age Pensions might discourage thrift, forethought, and diligence. But it might have the very opposite effect. Men might work and save to supplement a future pension, who, in present circumstances, see no prospect of providing for their old age, and therefore make no effort in that direction.

Political Economists differ greatly from one another in their attitude towards Socialistic proposals. They almost all agree that the complete Socialism, under which the State

owns the instruments of production, and directs the national industries, is for the present impracticable. Some of them, however, look forward to realising some approach to this system in the course of a few generations. Others regard it as a distant ideal, towards which, however, we are moving, and should move. A fourth section either disbelieves in the Socialistic ideal, or relegates its realisation to a very distant future, but yet favours some or all of the eight tendencies enumerated above. While a fifth party considers that we have already gone too far in a socialistic direction, and advocates a return to more freedom of competition. The fourth of these parties seems at present the strongest, and has to be further subdivided, according to whether they view with favour the extension of the direct employment of labour, and direction of industries by the State, the Municipalities, and other local authorities.

Such differences of opinion have probably done something to discredit the study of Political Economy. It should, however, be understood that our science may help the solution of social difficulties, without being able to give a definite answer to the complicated questions touched in this chapter. It may enable students better to realise both the advantages and disadvantages of proposals upon which it cannot pass a final judgment.

Meanwhile, the variety of opinion among the experts seems at least to suggest the great importance of not moving in a Socialistic direction, except in a very gradual and tentative way. At every step we incur dangers, the magnitude of which it is impossible to estimate with any exactitude. But this seems no sufficient reason for acquiescing in a social system which dooms the majority of its members to

excessive labour and insufficient comfort, to a narrow culture and a brutalising competition, while it dooms a minority to still worse conditions—shortening to life, demoralising to character, and ruinous to self-respect. Hasty and unwise changes might intensify these evils; but an unwise caution may not only leave them without a cure, but may provoke a rebellion of the hungry, more fatal to social well-being than even unwise legislation. In conclusion, therefore, we shall venture to point out the lines on which progress seems most hopeful.

It has already been implied, that by improving the conditions of child-life, the State is adding ultimately to the efficiency of labour. The more it can equalise opportunities, the more it can rely on securing <sup>Socialism for the young.</sup> the best industrial services hereafter. A single scientific discovery may revolutionise an industry, or save it from destruction. Yet, under present conditions, many of the children are denied the opportunity of developing their talents. We need to carry further the means for the best possible education of those who are best fitted to profit by it. Whether the State should also see to the proper feeding of the children is a more difficult question. Considerations of expense cannot be ignored, and there are serious objections to interferences with parental responsibility; but, on the other hand, physical well-being is essential to proper development.

Having done what it can to equalise opportunities, it is doubtful if the State will not do more harm than good by attempting to regulate the wages or hours of labour of its citizens. The hard discipline of <sup>Socialism for the aged.</sup> free competition will call forth powers that would otherwise have lain dormant. Individuals will generally understand

and promote their own interests better than the State can do. Labour will be, as a rule, most wisely and efficiently directed when the director is allowed liberty to make his own experiments by free contract with the labourers, and to secure a large remuneration for successful direction. Some limitations in freedom of contract are no doubt necessary; but it is doubtful if these can advantageously be carried much further than they are at present. The State, having cared for the children, must, in the main, leave the adults to look out for themselves during the busy years of life. When, however, those have passed, there seems again to arise the need for mitigating the evils of competition. Deserving people should not be driven to the workhouse, merely because they have not been able to make adequate provision for their old age. There are of course difficulties as to the best way of meeting this need. But the State, in helping its deserving aged, need not materially check the motives for industry, exertion, and self-reliance, at least if it be admitted that it is not at present reasonable to expect the poor to make adequate provision for their own old age. A considerable amount of Socialism for the aged, as well as for the young, may be combined with the retention of a system mainly based on individualism, for those who are doing the active work of the world, and on whom, in some way or other, the support of the aged must fall.

Whatever degree of Socialism be accepted, the cost must be borne. It seems reasonable that this should fall, as far as possible, on the wealthy. Care must, however, be taken not to unduly check the accumulation of capital, or the earnings of successful management. How far it is desirable to graduate taxation is a difficult question.

Socialistic  
Taxation.

The present system, which favours small incomes, but puts moderate and large incomes on an equality, does not seem reasonable.

• It may next be pointed out, that while men naturally desire to dispose of their wealth by will, they will be even less willing to have it taken from them, in the form of taxation, during their lifetime. The transmission of large fortunes is, in many respects, injurious to the State, ~~as it~~ tends to put power (including the direction of industry), into the hands of the incompetent, as well as to create a class of "idle rich."

Of taxes on the living, those that fall on "land" are economically less objectionable than those that fall on capital or on earnings. It must, however, be remembered that agricultural land is to a great extent a manufactured article, and belongs rather to the category of "capital."

*Urban* land, and all land on which houses are built, and still more, *unused* land, held for speculative purposes, are more appropriate subjects for taxation than land on which capital has been expended, in ways that make it impossible to distinguish "land value" from improvements.









